

The Trouble with Tax Avoidance:
Two General Anti-Avoidance Rules, a Judicial Doctrine, and their
Respective Implications for the value of Certainty in Tax Law

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Finally, thanks to Jesus Christ, my Lord, to whom I owe everything. It has been the habit of many notable artists, composers and academics throughout the years to write, at the conclusion of their work, “S.D.G.” short for “Soli Deo Gloria,” or “Glory to God alone.” It is my honour to do likewise.

Although I am exceedingly grateful for the many helpful comments which I have received on earlier drafts of this work, I must take full responsibility for any errors or shortcomings contained within this document. The law is stated as of 31 March 2013.

Joshua Fowler
University of Canterbury
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STYLE

The author has sought to follow the New Zealand Law Style Guide (Thomson Reuters, 2011, 2 ed.)

ABSTRACT

Tax avoidance is an exceedingly complex area of law. It is also a matter generally found not far from the headlines, or from the concerns of state and policy forums such as the G8 and the OECD. In an increasingly capital mobile world, the concern on the part of Governments for the protection of their sources of revenue has increased.

Adam Smith's four canons of taxation are well known. In his work, *The Wealth of Nations*, Smith regarded the values of certainty, equity, efficiency and convenience as integral to the functioning of a tax system. Among these, however, Smith would seem to have regarded certainty as of particular significance. The prominence afforded to the value of certainty, in conjunction with the smaller role afforded the state likely contributed to the formalistic approach taken by the courts of the British Commonwealth to the interpretation of taxing statutes. In recent times, however, the importance of certainty among policy makers and jurists has declined. Although this is not to contend that the value of certainty has ceased to be a consideration, it would seem to have come to be regarded as a lesser value among many rather than an end in itself.

Although the optimal level of certainty within a jurisdiction is undoubtedly a matter for debate, the presence of uncertainty may carry with it a number of risks and unintended consequences which may hinder the achievement of the ends sought after by policy makers. These may include an increase in the rate of capital flight and in the use of asset sheltering devices, a decrease in the incidence of economic activity, and decreased rates of compliance among taxpayers. The value of certainty, in other words, may be of greater significance to the efficient functioning of a tax system than it has in recent times been thought to be.

In contending with tax avoidance, the countries of the British Commonwealth tend to employ either one of two instruments; a statutory General Anti-Avoidance Rule (GAAR) or a judicial doctrine; an innovation of the common law. In this thesis, the writer sets out to examine the judicial doctrine applied in the jurisdiction of the United Kingdom (UK), and the statutory GAARs deployed in Canada and New Zealand, and the respective implications of each instrument for the value of certainty.

While the difference in the implications presented by the application of a broad judicial doctrine and a narrow GAAR may be slight, it is the writer's contention that, all things held equal, the use of a judicial doctrine is likely to have a less deleterious effect on the value of certainty than a GAAR. Accordingly, it is the writer's contention that the use of a judicial doctrine is for this reason preferred.

I INTRODUCTION

A Background

Adam Smith's four canons of taxation are well known among tax practitioners and laypeople alike. In his magnum opus, *An Enquiry into the Wealth of Nations*,¹ Smith set out four basic principles by which a sound and efficient tax system might be recognised. These were equity, certainty, convenience and efficiency.

1 The Value of Certainty

A study of the extent to which the tax law of a given set of countries gives effect to any one of these values would make for an important contribution to tax literature. Yet the writer has chosen to confine the scope of his discussion to the principle of certainty in the context of recent developments in the tax law of the jurisdictions of the United Kingdom (UK), Canada, and New Zealand (NZ)² in dealing with income tax avoidance.³

While the concepts of fairness and equity may be of greater significance in other areas of the law,⁴ at least from a business perspective, the value of certainty is, in the writer's view, most consequential. This is largely as a product of the desire on the part of businesses to plan and structure their affairs in the most tax efficient manner possible.⁵

A concern for the value of certainty tends in most (though by no means all) cases toward a preference for specific, over general, rules or, in other words, for "rules" over "principles" based legislation. This is not to say, however, that general rules do not have a place within the tax code; indeed, they are arguably indispensable to the administration of the tax law. However, it is the writer's view that their utility is at times undermined by the unintended consequences which follow from their application. Often, these take the form of confusion, unpredictability, and uncertainty.

¹ Adam Smith *An Enquiry into the Wealth of Nations* (5th Ed, London: Methuen & Co., Ltd. 1904) Library of Economics and Liberty <www.econlib.org>.

² The jurisdictions of the United Kingdom and New Zealand are referred to either in full or as the UK or NZ, respectively.

³ Rather than, for instance, Goods and Services Tax (GST) or Value Added Tax (VAT).

⁴ Echoes of a concern for certainty may be found in The Report of the Tax Working Group, which identified coherence, integrity and fairness among its concerns; see "A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group" (January 2010).

⁵ Indeed, fiscally uncertain jurisdictions may incur costs in the form of difficulties in attracting overseas investment and experience greater trouble with issues such as asset sheltering and capital flight.

Among modern day academics and policy makers, however, the significance of certainty has waned. Writing in support of the value of certainty therefore places the writer in the minority so far as the trend in modern scholarship is concerned.

B Smith's Doctrine of Certainty

In his *Enquiry into the Wealth of Nations*, Smith wrote the following:⁶

The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gathered, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. *The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.*

It would seem that Smith regarded the value of certainty as a matter of significant importance. In his view, the value of certainty in tax law guarded against a multitude of vices, among which he included the corruption of the collectors of revenue, and the extortion of private property. The value of certainty might thus be seen as integral to promotion of individual liberty. But what, it might be asked, does the concept of certainty entail? This is a matter upon which the writer hopes to shed light as he proceeds.

C Thesis

In this thesis, the writer examines two approaches to dealing with income tax avoidance represented by the use of a judicial doctrine or a General Anti-Avoidance Rule (GAAR), and their relative implications for the value of certainty.

It is the contention of the writer that the use of general rules in the form of GAARs and judicial doctrines to address tax avoidance both present inroads into the values of certainty and predictability and undermine the taxpayer's ability to intelligently order his or her affairs. Accordingly, the use of specific rules for this purpose is favored. Where, however, the use of either a general rule or a judicial doctrine is unavoidable, it is the writer's view that a judicial doctrine is likely to be considerably less detrimental to the value of certainty than a general

⁶ Adam Smith *An Enquiry into the Wealth of Nations*, above n 1, at V.2.26 (emphasis added).

anti-avoidance rule, and should, for this reason, be preferred. It is chiefly for this reason that the writer favours the UK's use of a judicial doctrine as opposed to the forms of general statutory rule deployed in Canada and New Zealand.

D Method

The writer seeks to subject the approach taken to tax avoidance by a selection of the countries of the British Commonwealth to a “black-letter law” analysis.⁷ The writer's intent is to determine which approach best gives effect to Smith's value of certainty. The analytical approach adopted might therefore be described as “comparative black-letter law.”

1 Black-Letter Analysis

The “black-letter law” analysis was defined by Michael Salter and Julie Mason as “a research methodology that concentrates on seeking to provide a detailed and highly technical commentary upon, and systematic exposition of, the content of legal doctrine.” Margaret McKerchar referenced Judith Freedman's description of research in law as being rarely concerned with finding new facts or information but rather more likely to consist of “careful study” requiring classification, analysis and theorization.⁸ This, McKerchar wrote, usually reflected a “black letter” approach to the law which sought to “fit cases and legislation into a rational framework thereby identifying internal inconsistencies.”⁹

Limitations of the black-letter method include the criticisms that the black letter tradition has led to the oversimplification of both legal doctrine and processes, fails to capture the complexity of law in action within modern society, and overlooks the role of subjective interpretation as well as the dynamic nature of the law, among other matters.¹⁰ These shortcomings notwithstanding, however, it is the writer's view that the black letter method nonetheless represents a useful and focused means of legal analysis.

⁷ Michael Salter and Julie Mason *Writing Law Dissertations — an Introduction and Guide to the Conduct of Legal Research* (Pearson Longman, 2007) 113. See 108 – 118 for further discussion of the “black letter” approach to legal analysis.

⁸ Margaret McKerchar *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters, 2010) at [1.60] quoting Judith Freedman “Taxation Research as Legal Research” in M Lamb, A Lymer, J Freedman and S James (eds) *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press, Oxford, 2005) at 13.

⁹ Margaret McKerchar *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters, 2010) at [1.60]

¹⁰ Salter and Mason, above n 7, at 108.

2 *A Comparative Approach*

Salter and Mason regarded comparative research as asking how different legal systems and legal cultures “addressed problems that our law faces, but in a different way, and with what degree of perceived success or failure.”¹¹ Such research, the authors continued, could include a policy aspect, “particularly where law reform organisations attempted to learn lessons potentially available from the relative success and failure of reforms within other similar legal systems.”¹²

Limitations of the comparative method are that it may be time-consuming and difficult to timetable accurately, and access to primary sources can be limited. This may lead in some cases to reliance upon secondary sources such as articles and textbooks which may be out of date.¹³ Additionally, there is the risk that the critical analysis of policy lessons may be overlooked in favour of a point-by-point comparison of the details of positive law in the jurisdictions compared.¹⁴ However, in the writer’s view, the comparative method provides a helpful means of deriving shared lessons across jurisdictional boundaries.¹⁵

E Chapter Content

Here, the writer would first seek to explain his reasons for selecting the jurisdictions which he has for discussion, before presenting an explanation of the content contained within the Chapters which follow. It is worth reiterating that the intent of each jurisdictional survey is to discern the impact that the use of its chosen implement for addressing tax avoidance has for the value of certainty within that jurisdiction. These matters are the subject of further discussion in Chapter Seven.

1 Reasoning

In order to maintain a manageable scope for research the writer has confined his attention to the case law of three jurisdictions; the United Kingdom (UK), Canada and New Zealand. The United Kingdom was chosen primarily as it is the only jurisdiction to deal with income tax avoidance by means of a judicial doctrine alone;¹⁶ it therefore provides an opportunity to compare and contrast the use of a judicial doctrine with the deployment of a statutory GAAR.

¹¹ At 183.

¹² At 183.

¹³ At 189.

¹⁴ At 190.

¹⁵ Konrad Zweigert and Hein Kötz *Introduction to Comparative Law* (2nd ed, Clarendon Press, Oxford, 1987).

¹⁶ It is, however, shortly to enact a GAAR. This is discussed in Chapter four.

In contrast, Canada was selected as it is home to what is perhaps (in the writer's view) the most potentially aggressive GAAR in the British Commonwealth. A discussion of s 245 of the Canadian Income Tax Act 1985 offers insights into the kinds of issues that may await jurisdictions which elect to follow in Canada's footsteps. New Zealand was included not only as it is the jurisdiction of which the writer is a citizen and presently resides in, but also as there have been a number of recent significant developments in its tax jurisprudence which it would be unfortunate to leave unmentioned.

Notable among the jurisdictions not surveyed is Australia. Although often treated as the first point of comparison wherever a discussion of New Zealand is undertaken, a discussion of the Australian position was not included for three reasons. First, because Australia's GAAR, Part IVA, is presently undergoing reform,¹⁷ and second, as a discussion of the implications of instruments designed for combating tax avoidance has in one sense to be carried out with reference to contrasting examples, the writer was concerned that there were almost too many similarities between the experience of Australia and New Zealand.¹⁸ Third, and finally, the constraints space of posed by an LLM thesis simply meant that a discussion of the Australian position would have been too large to include.

That said, the discussion presented in both the Canadian and UK Chapters may offer some insight into what may await Australia if its GAAR is strengthened (as the writer suspects it may be).¹⁹ The absence of Australia is, however, a limitation of this thesis.

2 *Subject of Discussion*

While the distinct implications for the value of certainty attaching to the use of judicial doctrine as opposed to a GAAR are essential to this thesis, there is, however, a crucial difference between the two instruments; where one is a product of gradual judicial development, the other is a statutory instrument. Accordingly, it is impossible to treat each in exactly the same way. Thus, in considering the UK's judicial doctrine, the focus is on the pronouncements of jurists and their treatment of prior authority in an effort to discern the tenets of the judicial doctrine as these fluctuate from one case to the next. By contrast, an examination of the respective GAARs of Canada and New Zealand emphasises a scrutiny of their respective statutory instruments, and the common and recurring conceptual difficulties which follow from their application.

¹⁷ Joshua Cardwell "Australia: Proposed Reforms to Part IVA" (7 January 2013) <www.mondaq.com>. See also Joanne Dunne "Amendments to Part IVA introduced into Parliament" (Minter Ellison, 15 February 2013) <www.minterellison.com>.

¹⁸ In this respect, Canada's GAAR which is arguably among the most aggressive in the Commonwealth might be said to provide a more use counterexample.

¹⁹ See PricewaterhouseCoopers (PWC) "Exposure Draft Legislation on Part IVA Reforms – Is There Reason for Concern?" (3 December 2012) <www.pwc.com.au>.

At all times, the aim is to understand the implications of the instruments deployed in the UK, Canada and New Zealand to deal with income tax avoidance for the value of certainty. That said, the mere fact that the writer may quibble with the approach taken by the judiciary in a particular case should not necessarily be taken to indicate disagreement with the result which it reached. Here, there is an important distinction between “process” and “product.”²⁰

Another recurring theme throughout this thesis is the question of the most appropriate response to tax avoidance arrangements. This takes many forms; for instance, could the courts, in being confronted with a particular scheme, have reached the same outcome without the use of a judicial doctrine or a GAAR? Were the collectors of revenue too eager to enlist the aid of such an instrument? Could cases of the sort at issue have been foreseen by the legislature and made the subject of a specific rule? Would it have been better for certainty if the scheme, rather than being struck down, was left as it was and the law amended to prevent the use of similar devices arising in the future?

One of the problems associated with the widespread use of both judicial doctrines and GAARs is that they can at times prove to be blunt instruments which produce confusing results; accordingly, it would seem prudent that they should be used sparingly and only where absolutely necessary.²¹ That said, it must again be emphasised that the use of a judicial doctrine would seem to be less detrimental to the value of certainty than a GAAR.

Tax avoidance is a highly complex area of law, and the transactions and arrangements contained within its jurisprudence are frequently intricate and multifaceted. A certain degree of detail is therefore necessary, both in presenting case law, and in considering the manner in which it is approached by the courts. Every effort has, however, been made to relate each point noted for consideration back to its repercussions for the value of certainty in order that recurring themes may be discerned not merely within, but also across, the jurisdictions considered.

Due chiefly to constraints of space, each Chapter is devoted to a discussion of the leading cases and foremost authorities in that jurisdiction. At times, the selection of these authorities has proved difficult. There are, for instance, many cases which the writer would very much like to have included either for their influence or for the points of interest which they present.

²⁰ This is particularly so of cases in which the taxpayer achieves the apparently “magic” result of creating a tax loss which is not a real loss of the sort articulated by Lord Fraser of Tullybelton in the case of *Inland Revenue v Burma Oil Co Ltd* [1982] SC (HL) 114 at 132. This view received some recognition in the case of *Ensign Tankers* in which it was said that a tax avoidance scheme had so far been recognisable by this “apparently magical result.” See *Ensign Tankers Ltd (Leasing) v Stokes (Inspector of Taxes)* [1992] 1 AC 655 at 676 per Lord Templeman.

²¹ This leads in many ways to a discussion of the appropriate balance between the use of general and specific rules. While this, in the writer’s view, is where the value of certainty is optimised (or at least caused to incur as little detriment as possible), opinions will differ. This is the subject of further discussion in Chapter Two and Chapter Seven.

In this respect, the writer has been guided in his selections by both academic scholarship and case law itself.

F Chapter Outline

Having now introduced the topic and method, some explanation of the following chapters would seem necessary. Where Chapter One is concerned with a brief introduction to the writer's topic and method, it is the concept of certainty which is the subject of discussion in Chapter Two. Chapter Three presents an inquiry into the nature of tax avoidance.

Chapter Four commences the jurisdictional survey by considering the legal position in the United Kingdom. Again, the UK was selected primarily as it is unique within the British Commonwealth in having sole recourse to a judicial doctrine for the purpose of tackling income tax avoidance; it does not, at present, have a GAAR. Accordingly, it provides an important contrast to the approach employed by the other member states of the British Commonwealth.

Chapter Five then proceeds to examine the Canadian position and to consider its GAAR and associated case law. Canada's GAAR is, in the writer opinion, an aggressive instrument, and its case law accordingly provides fertile ground for discussion. Chapter Six turns to a discussion of the approach taken to dealing with income tax avoidance in New Zealand, with particular reference to some of the more recent developments in its tax jurisprudence.²²

There are a number of common elements and themes which emerge from this jurisdictional survey. These are presented in the form of a summation and discussion of findings in Chapter Seven. Concluding remarks, limitations, and suggestions for further research are contained in Chapter Eight.

Each Chapter contains a short explanation of its direction under the heading "order of procession," which is designed to provide readers with a brief insight into its contents. Where a Chapter concerns a jurisdiction, its key cases are generally listed beneath this heading, albeit in the familiar, rather than formal, sense. For instance, the UK case of *W T Ramsay v IRC*²³ would be referred to as *Ramsay*, the case of *IRC v Burmah Oil Co*²⁴ as *Burmah*, and so

²² Notable for its omission from the discussion of New Zealand is the case of *Glenharrow Holdings Ltd v Commissioner of Inland Revenue (Glenharrow)* [2008] NZSC 116. Although a tax case of some significance, *Glenharrow* has been omitted as it concerns Goods and Services Tax (GST) rather than income tax. It should be said, however, that the case of *Glenharrow* follows a similar approach to that set down in the case of *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC). There is also a material similarity between s 76 of the Goods and Services Tax Act 1985 and s BG 1 of the Income Tax Act 2007. The extent to which the jurisprudence of s 76 and s BG 1 interacts with one another is a matter of debate.

²³ *W T Ramsay v IRC* [1982] AC 300.

forth (these cases are the subject of a full citation nonetheless). However, when these cases become the subject of discussion, they are introduced formally, and in full.

²⁴ *Inland Revenue v Burmah Oil Co Ltd* [1982] SC (HL) 114.

II CERTAINTY

A Introduction

1 Contending with Certainty

Adam Smith's remarks in his 1776 work *The Wealth of Nations* indicate that he attached considerable significance to the value of certainty within the tax law. However, given the historical context in which Smith was writing, this should perhaps come as little surprise. The principle that there should be no taxation without representation had already been entrenched in the British constitution through Magna Carta and Bill of Rights Act 1688, and was arguably at the forefront of the American Revolution.¹ The issue of taxation was then a matter of the utmost importance.

It should be said, however, that Adam Smith wrote at a time in which the exercise of state authority could be particularly harsh, arbitrary and unprincipled. As this is perhaps less of a concern for the jurisdictions of the British Commonwealth in the present day, changes in culture, context and to the passage of time may mean that understandings of the importance and value of the principle of certainty now differ from those which prevailed at the time in which Smith was writing. It is therefore possible that Smith, were he writing today, might approach the matter differently. After all, tax is, for states, a practical necessity. Yet this is arguably understood by most taxpayers; in this respect, it is not the need for tax that taxpayers contest so much as the rate of taxation, the use to which public funds are put, and the imposition of taxation on arbitrary terms.

In this sense, to the extent that the value of certainty contributed to reducing the incidence of state excess, it would seem relevant to maintaining a sound and principled approach to the administration of a tax system still, and in light of its role in history, possibly even civil order besides. In these sense, the value of certainty may act to guard against a return to the arbitrary exercise of authority which plagued Smith's era, as indeed some modern commentators contend.

2 Order of Procession

This Chapter considers the concept of certainty and its connection to the rule of law. Attention is then given to the change in social policy goals which has taken place in recent years among policy makers, academics, and jurists. The Chapter then proceeds to examine

¹ Shelley Griffiths "Tax as Public Law" in Maples and Sawyer (ed) *Taxation Issues: Existing and Emerging* (The Centre for Commercial and Corporate Law, University of Canterbury, 2011) 215 at 216, 219 - 220.

the risks associated with a climate of uncertainty, and the question of whether there is a relationship between certainty and fairness. A brief outline of jurisdictional trends follows.

B What is Certainty?

1 Definitions

The Oxford English Dictionary (OED) defines the word “certain”² as; “determined, fixed, settled; not variable or fluctuating; unfailing” and also as “definite, exact, precise.”³ However, the OED distinguishes between certainty which is objective, and that which is subjective. While the former is variously defined as “the quality or fact of being (objectively) certain,” the latter is defined as “the quality or state of being subjectively certain; assurance, confidence; absence of doubt or hesitation.”⁴

2 Subjective and Objective Certainty

In distinguishing between objective and subjective certainty, the OED arguably offers an important insight into the characteristics of specific provisions. Where the concept of objective certainty likely relates to the combination of words comprising a specific provision, the concept of subjective certainty would, by contrast, seem to pertain rather to the resulting subjective mental state of the taxpayer upon reading it. Taken together, a *certain* tax law must be one which satisfies both criteria. A certain provision must be written in objectively precise and exact language such as to have the effect of instilling in the taxpayer the confidence that his or her interpretation is accurate.⁵

² The etymological origins of the word “certain” lie in the Old French *certain*, and the late Latin or Romanic type *certānus*, *certāno*, where Latin *certus*, was generally given to mean “determined, resolved, fixed, settled, purposed, certain.” (Perseus Digital Library, Tufts University, 2013) < www.perseus.tufts.edu >.

³ Oxford English Dictionary <www.oed.com>.

⁴ OED, above n 3.

⁵ The “acid test” of the objective certainty of such a specific provision might be the extent to which a reading of its language induces a common understanding among a group of taxpayers. In other words, if a group of taxpayers were able to independently read a specific provision and reach a similar understanding of its contents this might *prima facie* be taken as indicator of a provision which satisfied both requirements. Conversely, indicators of legislative failure might present themselves either in the form of what the legislature might consider an erroneous common understanding amongst taxpayers, or as quarrels or contention as the meaning of the provision.

C Certainty and the Rule of Law

1 Smith, Dicey and Hayek

Smith's principle that the amount of tax payable should be certain is to an extent corroborated by the work of A. V. Dicey on the pre-eminence of the rule of law. Although it is by no means suggested that the work of the two theorists is without difference, there would seem to be a significant measure of overlap between the two, particularly in light of the concern of both authors for the arbitrary exercise of state authority. Dicey defined the concept of the rule of law as:⁶

...the absolute predominance of regular law, so that the government has no arbitrary authority over the citizen; the equal subjection of all (including officials) to the ordinary law administered by the ordinary courts; and the fact that the citizen's personal freedoms are formulated and protected by the ordinary law rather than by abstract constitutional declarations.

These sentiments were echoed by the economist and political philosopher Friedrich Hayek, who, in his work *The Road to Serfdom*, opined:⁷

Nothing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law. Stripped of all technicalities, this means that the government in its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances and to plan one's individual affairs on the basis of this knowledge.

A common thread in the pronouncements of Smith, Dicey and Hayek is a shared abhorrence of the arbitrary exercise of state authority. These authors regarded the values of transparency and certainty as important restraints on the incidence of discretion, corruption, and state excess within a jurisdiction. Perhaps particularly in light of the state's power to both collect taxes and imprison its citizens, these theorists advocated measures that would ensure that the state and its officials operated within the ambit of the law, rather than in accordance with the mandate of their own discretion. The alternative in the minds of Smith, Dicey and Hayek

⁶ Jonathan Law and Elizabeth A. Martin "A Dictionary of Law" (7 ed) Oxford University Press 2012 <www.oxfordreference.com>.

⁷ Friedrich August von Hayek *The Road to Serfdom* (Routledge Classics, London 2001, Taylor and Francis e-Library 2005) at 76 as cited in Taxation Committee of the New Zealand Law Society, the Corporate Taxpayers Group, and the Taxation Committee of the New Zealand Institute of Chartered Accountants *Report: Improving the operation of New Zealand's tax avoidance laws* (2011) 17 NZJTL 351 at [2.45].

would seem to have represented a threat to both individual liberty and the promotion of a free society.

D Two Perspectives upon the Role of Certainty and the Rule of Law

At least partly as a consequence of the work of theorists such as Smith and Dicey, the value of certainty came, in the writer's view, to enjoy a privileged position amidst the pantheon of competing social policy values esteemed by countries within the British Commonwealth. As a consequence, the legislatures of the UK, Canada and New Zealand tended to draft legislation cautiously and deliberately. In turn, this was often construed formally and narrowly by the courts. Where a statute should present some cause for doubt as to its proper interpretation it was frequently read in favour of the taxpayer. Although the influence which theorists such as Smith and Dicey once exerted upon tax law has waned, the presence of similar themes can still be discerned within the work of modern commentators.

1 As an Enduring Influence

Eugen Trombitas, for instance, recently remarked upon the importance of certainty and fairness in the tax law and its connection to the related principle that, in a democratic society, there should not be taxation without representation. In Trombitas' view, the courts stood between the state and the citizen. The right that tax be "imposed with certainty and enforced impartially" had been entrenched in the Bill of Rights 1688.⁸ Accordingly, it was "incontrovertible" that the manner in which tax was imposed should not result in "prejudice to the citizen."⁹

In Trombitas' view there were two essential values within the tax system. First, that the taxpayer pay his or her share of taxes in accordance with the tax law, and second, that the tax must not be imposed arbitrarily or by discretion.¹⁰ The tension between these two values raised the question of which would present itself most prominently to the mind of the court in the interpretation of complex or "grey" issues.¹¹ If Parliament could impose taxes through complex deliberate tax rules, then it could also stipulate with certainty what constituted a permissible use of the same rules. If it did not, there was the risk that tax laws would be applied and tax imposed on an "incoherent basis" through a reliance upon the deterrent effect of a general anti-avoidance rule as the model for "achieving a state of equilibrium between the fundamental values" in New Zealand's tax system.¹²

⁸ Bill of Rights 1688 (UK).

⁹ Eugen Trombitas "The Conceptual Approach to Tax Avoidance in the 21st Century: When the Statute Gives But the GAAR Can Take Away" (2009) 15 NZJTL 352 at 387.

¹⁰ At 388.

¹¹ At 388.

¹² At 389.

2 *A Justified Breach of the Rule of Law?*

John Prebble and Rebecca Prebble (Prebble and Prebble) took a different perspective.¹³ The authors argued that most legal philosophers considered that a law must be “relatively certain” to fulfill the principles of the rule of law. In the authors’ view, it was this requirement of certainty that GAAR contravened.¹⁴ In brief, Prebble and Prebble regarded GAARs as representing a breach of the rule of law for several reasons. The two most notable of these are for present purposes first, that in being uncertain, vague and difficult to apply, they put people at the risk of coercion in not knowing whether their actions would be caught by them.¹⁵ Second, it was debatable as to whether GAARs satisfied the formal criteria required for law to exist.¹⁶ However, tax avoidance, in the minds of the authors, undermined two key purpose of a tax system. First, horizontal equity, under which those in the same economic position should be taxed at the same rate, and second, economic neutrality. As tax was necessary to keep states functioning,¹⁷ a strict adherence to the rule of law could inhibit the realisation of society’s other goals. A breach of the rule of law, in the authors’ view, seemed to be a “necessary remedy.”¹⁸

3 *A Clash of Values?*

A significant element of the contrast in views underpinning the purpose and operation of a tax system would seem explicable by way of reference to the level of relative importance afforded by each party to the values of certainty and equity. However, where the value of certainty was once considered to be almost paramount, it is arguable that the pendulum has swung now such that the value of equity has achieved greater prominence. The interaction and relationship between these two values is a source of considerable academic debate.

E Modern Attitudes to Certainty

1 Changing Minds

Those whose views are more aligned with the position advanced by Prebble and Prebble have, in recent years, become increasingly prominent in the fields of law and policy. This

¹³ Rebecca Prebble and John Prebble “Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study” (2012) 2(2) Saint Louis University Law Journal 21.

¹⁴ At 28 (emphasis added).

¹⁵ At 22, 30, 32.

¹⁶ At 37

¹⁷ At 40.

¹⁸ At 40.

would tend to indicate that the significance of the value of certainty has, in the eyes of many modern commentators, become much reduced.

For instance, Professor Judith Freedman contended that while certainty had great significance in the fields of commercial and criminal law, there were circumstances in a tax context in which it should not be the overriding aim and might prove to be elusive or undesirable.¹⁹ Freedman's sentiments were echoed by no less an august authority than the Supreme Court of New Zealand when it remarked that New Zealand's GAAR had been left "deliberately general" and that it was not the role of the courts to create "greater certainty than Parliament had chosen to provide."²⁰ New Zealand's Inland Revenue argued to similar effect in a recent draft Interpretation Statement that it was not "as clear cut as might be suggested" that certainty was either possible or desirable in the area of tax avoidance, "particularly where arrangements [were] at the avoidance boundary."²¹

2 *Changing Social Policy Goals*

This significant change in sentiment might in part be ascribed to the quiet revolution that has taken place in the realm of social policy in recent decades, particularly within Western nations. As David Dunbar has observed, tax law is no longer just about raising revenue, but also the achievement of social and economic objectives.²² Where the primary role and function of the state might once have been understood as the protection of individual liberty and private property, this is almost certainly no longer the case. In the modern era, social policy has come to include the promotion of broader, more egalitarian conceptions of social welfare such as income equality and redistribution.²³ Consequently, the value of certainty is arguably now regarded as one competing value among many rather than as an overriding aim or goal in itself. As a consequence, the level of certainty present within the tax systems of the jurisdictions which comprise the British Commonwealth has arguably declined, as indeed changes in their respective approaches to statutory interpretation might be taken to suggest.

¹⁹ Judith Freedman "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle" [2004] 4 BTR 333.

²⁰ *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC) at [112].

²¹ Inland Revenue "Interpretation Statement: Tax Avoidance and the Interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007" (16 December 2011) at [48].

²² David Dunbar, "Tax Avoidance: A Judicial or Legislative Solution; Lessons for the United States from the British Commonwealth" (2010) Nov *Corporate Business Taxation Monthly* 21 at 24.

²³ At 24

F Statutory Interpretation

Along with a change in the social policy goals of the jurisdictions of the UK, Canada and New Zealand has also come an alternation in the approach of their respective courts to the construction of fiscal statutes. Traditionally, the application of tax Acts was restrained and cautious. For instance, in *R v Winstanley*,²⁴ Lord Wynford wrote that if there should be any doubt about the words of the legislature, the benefit of that doubt should be afforded the subject.²⁵ Lord Cairns, in the case of *Partington v Attorney-General* took the view that form, in fiscal cases, was “amply sufficient.”²⁶ Essentially, the courts viewed the sole purpose of taxation as raising taxes; matters of context or statutory purpose were generally considered to be irrelevant to the interpretation of tax legislation. The courts to some extent also regarded tax legislation as depriving taxpayers of their property, and accordingly construed this as narrowly as any other Act infringing individual rights, privileges, and property.²⁷ Among the tools of statutory interpretation, it was the literal rule which most often prevailed. While the golden rule was at times enlisted, the mischief rule was generally ignored or regarded as inapplicable so far as matters such as tax were concerned.²⁸ It was this approach that the advent of the case of *The Duke of Westminster*²⁹ acted to entrench, to varying extents, within the tax law of the UK, Canada and New Zealand.

Eventually, however, these jurisdictions came to adopt broader, more purposive approaches to the construction of fiscal statutes.³⁰ This arguably began in UK with the advent of *W T Ramsay v IRC*,³¹ and in Canada, with the case of *Stubart v R*.³² In New Zealand, the Court of Appeal judgment in the case of *Challenge Corporation v CIR*³³ would seem to have had a similar effect in ushering in the “scheme and purpose” approach to statutory interpretation.³⁴ The emphasis which the jurisdictions of the UK, Canada and New Zealand now place upon the role of context and purpose can at times be discerned from the language employed in their

²⁴ *R v Winstanley* 5 ER 261.

²⁵ Thomas Gibbons “Great Elucidations: The Interpretation of Revenue Statutes in New Zealand” (2001) 9 Waikato Law Review 63 at 64, 65. See *Winstanley*, above n 24, at [150] per Lord Wynford.

²⁶ *Partington v Attorney-General* (1869-70) LR 4 HL 100 at 122 per Lord Cairns.

²⁷ Stephen W Bowman “Interpretation of Tax Legislation: The Evolution of Purposive Analysis” (1995) 43(5) Can Tax J Rev Fiscale Can 1167 at 1170.

²⁸ At 1172, 1174.

²⁹ *Commissioners of Inland Revenue v His Grace The Duke of Westminster* AC 1936.

³⁰ The purposive approach arguably represents the development of the mischief rule, which asked, in essence, what was the defect of the common law that Parliament intended to remedy. See Duncan Webb, Katherine Sanders and Paul Scott *The New Zealand Legal System: Structures and Processes* (5th Ed, LexisNexis, Wellington, 2010) at 332.

³¹ *W T Ramsay v IRC* [1982] AC 300.

³² *Stubart Investments Ltd v R* [1984] 10 DLR (4th) 1.

³³ *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1986] 2 NZLR 513

³⁴ Gibbons, above n 25, at 69.

respective statutes and case law. In the UK, for instance, in the case of *MacNiven v Westmoreland Investments*³⁵ Lord Hoffmann remarked that there was only one principle of construction, which was “to ascertain what Parliament meant in using the language of the statute.”³⁶ In New Zealand, s 5 of the Interpretation Act 1999 states that the meaning of an enactment is to be understood “from its text and in the light of its purpose.”³⁷ While other examples might be adduced, the essential point is that the interpretation of fiscal Acts is no longer bound by strict legal form.

Even so, authors J. F Burrows and R. I. Carter have argued that the purposive approach has not made the impact in tax Acts that it has in other areas for the reason that in most cases, the only evidence of “purpose” is the technical wording of the statutory provisions themselves. Hence, the authors wrote, the safest approach was to read the word “in their most natural sense.”³⁸ The point made by Burrows and Carter is an important one. In one sense, the reason that tax Acts have so often been interpreted formally is that these, perhaps more any other class of statutes, with their many specific rules, lend themselves most readily to such a construction. Thus, it might be asked, is the tendency toward a formalistic approach to the construction of fiscal statutes attributable to the approach of jurists, or rather a consequence of the inherent nature of the Acts themselves? To this, there would seem no clear answer, hence, one might conclude, the correct approach to the construction of tax Acts remains contentious still.

In summation, so far as the interpretation of fiscal statutes is concerned, the last 50 years have witnessed a significant change toward a broader, more contextual approach to statutory construction in the jurisdictions of the UK, Canada and New Zealand. The extent to which tax statutes are interpreted in the same manner as other statutes remains contentious, in part due to the highly detailed and specific nature of many taxing provisions. Whatever the extent and merit of this development, however, the application of fiscal legislation has arguably become less certain.

G Uncertainty and Risk

The relative merits of a more purposive approach to statutory construction aside, a less certain approach to the application of fiscal statutes carries with it a number of risks. An excessively broad approach to purposive interpretation or to the application of a judicial doctrine or GAAR presents the risk of the judiciary acting beyond its authority and, rather than applying the law, deciding upon its content instead. Hence, jurisdictions with significant

³⁵ *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311.

³⁶ At [29] per Lord Hoffmann.

³⁷ Section 5 Interpretation Act 1999 (NZ).

³⁸ JF Burrows and RI Carter *Statute Law in New Zealand* (LexisNexis, Wellington, 2009) at 217.

levels of uncertainty may encounter greater numbers of difficulties in the spheres of statutory interpretation, commerce, taxpayer compliance, and the administration of public policy than jurisdictions which, by contrast, have a greater level of certainty. In other words, the presence of uncertainty within a jurisdiction may carry with it a number of dangers and unintended consequences.

1 *Statutory Interpretation*

The excessively broad use of a purposive approach or GAAR risks the courts transgressing their jurisdiction and, in seeking to give effect to what they imagine to be the intent of the legislature, creating, rather than interpreting, the law. In *Mangin v CIR*³⁹ Lord Donovan, speaking of the application of New Zealand's then GAAR, s 108 of the Income Tax Act 1954, wrote that judges, in searching for an interpretation of the GAAR which was both "workable and just" approached the line where interpretation ceased and legislation began; a line which they were not to cross.⁴⁰ Dissenting in that case, Lord Wilberforce, however, argued that the application of s 108 caused the limits of judicial interpretation to be passed.⁴¹ More recently, Judith Freedman drew attention to the "thin dividing line" between "overriding a specific statutory purpose" through the GAAR, which was not permitted, and "employing the GAAR as a tool to protect the specific legislation from frustration," which was.⁴² Jurists and academics are apparently only too aware of this difficulty, which would seem to arise particularly with the use of a GAAR.

2 *Economic Activity and Capital Flight*

The presence of uncertainty may act to inhibit the size and incidence of economic activity within a jurisdiction.⁴³ The argument is that if taxpayers have a greater need to seek advice as to the legal and commercial implications of their proposed course of dealing, then the cost of transacting will rise and capital will be directed away from more productive employment and towards meeting the costs of compliance instead.⁴⁴ Consequently, productivity and efficiency may be decreased, and the overall health of an economy impaired.

³⁹ *Mangin v Commissioner of Inland Revenue* [1971] 2 WLR 739.

⁴⁰ At 149 per Lord Donovan.

⁴¹ At 756, 757 per Lord Wilberforce.

⁴² Judith Freedman "Interpreting Statutes: Tax Avoidance and the Intention of Parliament" (2007) 123(Jan) LQR 53.

⁴³ Taxation Committee of the New Zealand Law Society, the Corporate Taxpayers Group, and the Taxation Committee of the New Zealand Institute of Chartered Accountants Report "Improving the operation of New Zealand's tax avoidance laws" (Auckland, 2011) at [2.46].

⁴⁴ At [2.46].

It is also possible the presence of uncertainty within a jurisdiction may contribute to the use of asset sheltering devices or to capital flight. The extent of this influence is, however, difficult to discern, and research into the effect of uncertainty on capital flight has yielded mixed results. In 1989 Alberto Alesina and Guido Tabellini suggested that uncertainty over the fiscal policies of future governments in developing countries might result in capital flight.⁴⁵ In contrast, Rina Bhattacharya in 1999 found that the probability of a tax on income from domestic capital would not necessarily lead to more capital flight.⁴⁶ However, in 2000, Robert Lensink, Niels Hermes and Victor Murinde examined the relationship between political risk and capital flight for a set of developing countries, and found support for the hypothesis that political risk led to increased capital flight.⁴⁷ Thus, although it would seem possible that the presence of uncertainty may exert some influence on the incidence of capital flight, its significance is likely to be a question of fact and degree in each case. Additionally, as research into capital flight has at times focused on developing, rather than developed, economies, the extent to which the same lessons might be said to hold for the jurisdictions of the UK, Canada and New Zealand is unclear.

An uncertain tax environment may also carry within it implications for both foreign and domestic investment in that jurisdiction. In this respect, the New Zealand Corporate Taxpayers Group argued that certainty was essential to a small economy such as New Zealand, which was “heavily dependent” on foreign capital to finance both the public and private sectors. Larger economies, it wrote, might be able to have unusually uncertain tax laws if investors saw a benefit from access to a large or growing market. However, New Zealand did not have that luxury.⁴⁸

This argument would seem to have real world applications. In 2012 Andrew White emphasised the role of the rule of law and a transparent legal system to attracting investment. Echoing Smith, Dicey and Hayek, White urged against the arbitrary application of laws and regulations, and argued that investors would “think twice” about investing in a jurisdiction if there was doubt that contracts would be honoured and legal frameworks observed.⁴⁹ It is also interesting to note that India recently delayed the implementation of its statutory GAAR under pressure from the foreign investment community after concerns emerged as to its scope and application.⁵⁰ Denis O’Brien similarly expressed concern for the potential for tax

⁴⁵ Alberto Alesina and Guido Tabellini “External Debt, Capital Flight and Political Risk” 27 JIE(1989) 199-220

⁴⁶ This may be due to differences in the models employed by the authors. Rina Bhattacharya “Capital flight under uncertainty about domestic taxation and trade liberalisation” 59 JDE (199).

⁴⁷ Robert Lensink, Niels Hermes and Victor Murinde “Capital flight and political risk” 19 JIMF (2000) 73-92

⁴⁸ Corporate Taxpayers Group, above n 43, at[2.50].

⁴⁹ Andrew White “In Race to Attract Investment, Indonesia Needs Rule of Law” (20 April 2012) Jakarta Globe <www.thejakartaglobe.com>.

⁵⁰ Dharmeh Pandya “India Delays Implementation of GAAR, Proposes Amending Key GAAR Provision” (18 January 2013) DLA Piper News Insights <www.dlapiper.com>.

uncertainties in Jamaica to drive investment away from the island.⁵¹ For those involved in business, trade and commerce, a certain tax and regulatory environment would seem to remain a pressing concern.

It should be said, however, that the interconnected nature of global business implies that movements of capital may have as much to do with external events as those occurring within the jurisdiction in which the capital presently resides. Thus, while the presence of uncertainty might act to deter investment or contribute to capital flight, the effect of the uncertainty within a jurisdiction might be mitigated if the jurisdiction also presents factors which are attractive to investors, such as, for instance, a comparatively higher growth rate. Similarly, if, all things held equal, a set of competing jurisdictions have similar levels of uncertainty, then movement of capital between them may be minimal. Hence, so far as capital flight or investment is concerned, much may depend on the interaction between a variety of contributing factors; in this respect, the argument is simply that the level of uncertainty within a jurisdiction is likely to be among them.

3 Costs for Governments

The presence of uncertainty may also carry substantial costs for governments, as the enforcement of GAARs or similar devices may be expensive. In Sir Ivor Richardson's view, there were problems with the concept of a GAAR operating as a deterrent because it risked inhibiting desirable activity, damaging relations between taxpayers and the revenue and tying up resources while the parties skirmished.⁵² These concerns would seem corroborated by the work of Mark Keating and Kirsty Keating who argued that general anti-avoidance rules consumed approximately 20 to 30 percent of the resources of Inland Revenue, the courts, taxpayers and practitioners, a figure which the authors regarded as excessive.⁵³

The implication is that the presence of uncertainty may result in the imposition of significant administrative, compliance and legal costs, both tangible and intangible, upon both taxpayers and the state alike. Thus, the use of devices such as GAARs may not always be cost effective or conducive to fostering taxpayer compliance, particularly if it contributes to the erosion of good will between the parties to the dispute.

⁵¹ Steven Jackson "Taxation Uncertainty Will Drive Investors From Jamaica, Says O'Brien" (24 March 2013) Jamaica Gleaner <jamaica-gleaner.com>.

⁵² Ivor Richardson "Countering Tax Avoidance" (2004) 10(4) NZJTL 301 at 304 as noted by the Corporate Taxpayers Group, above n 43, at [2.49].

⁵³ Mark Keating and Kirsty Keating "Tax Avoidance: The Camel's Back that Refuses to Break" 17 NZJTL 115 at 115, 138. Also noted by the Corporate Taxpayers Group, above n 43, at [2.52].

4 *The Findings of the Compliance Literature*

The realm of compliance literature measures the impact of a number of variables on taxpayer compliance. Although a complex area of study, one suggestion arising from this corpus of literature is that the presence of complexity in the tax law may in some circumstances negatively impact taxpayer compliance, and create uncertainty for taxpayers. This uncertainty may encourage, rather than deter, some taxpayers from engaging in tax avoidance.

In 1986, Jackson and Milliron set out to present findings on the effect of a range of variables on non-compliance, including fairness and complexity.⁵⁴ In an attempt to present a definition of complexity, Milliron had in 1985 studied taxpayers in the hopes of deriving a definition empirically. Complexity, Milliron found, contained four dimensions: the nature of the topic, the quantitateness of the presentation, the vulnerability of the law to misuse and the readability of the passage.⁵⁵ Long and Swingen, by contrast, enlisted the aid of tax preparers instead, and found that the two factors of excessive detail in the law and the many computations required accounted for 86 percent of the variation in the complexity scores of their subjects.⁵⁶

As Jackson and Milliron noted, however, efforts to test the effect of complexity upon compliance had yielded mixed results. While Westat had theorised that complexity increased taxpayer uncertainty and acted to deter taxpayer non-compliance,⁵⁷ the New York State Bar Association had argued that the complexity had the opposite effect on compliance, and aided “playing the tax lottery.”⁵⁸ Jackson and Milliron also drew attention to research carried out upon the effect of complexity on reporting position. Although some research had found the presence of complexity to be associated with significantly increased underreporting among non-business returns, the opposite effect had been found among business returns. This led the authors to contend that although complexity had a significant effect on reporting position in

⁵⁴ Betty R Jackson and Valerie C Milliron “Tax Compliance Research: Findings, Problems and Prospects” [1986] 5 *Journal of Accounting Literature* 125 at 138.

⁵⁵ V Milliron “A Behavioral Study of the Meaning and Influence of Tax Complexity,” (1985) (Autumn) *Journal of Accounting Research* 794 as cited in Jackson and Milliron, above n 54, at 138.

⁵⁶ S Long and J Swingen “Tax Professionals’ Perceptions of Federal Income Tax Complexity: Some Preliminary Findings” working paper, Center for Tax Studies, School of Management, Syracuse University (presented at the Northeast Regional Meeting of the American Accounting Association, April, 1985) as cited in Jackson and Milliron, above n 54, at 138.

⁵⁷ Westac Inc “Individual Income Tax Compliance Factors Study Qualitative Research (prepared for the Internal Revenue Service, February, 1985) as cited in Jackson and Milliron, above n 54, at 138.

⁵⁸ New York State Bar Association “A Report on Complexity and the Income Tax” (1972) (Spring) *Tax Law Review* 329 as cited in Jackson and Milliron, above n 54, at 138.

each case, the directional impact was mixed as a consequence of interaction with the compliance factors of perception of fairness and opportunity for evasion.⁵⁹

In 1990, Michelle White delved into the question of complexity within tax law.⁶⁰ White defined a more complex law as one in which more information is relevant to predicting the outcome of the dispute which required the parties to collect and evaluate more information in order to predict its outcome.⁶¹ White's argument was that US tax law was complex because both the IRS and tax professionals have a vested interest in complexity. This, she wrote, was because complexity within tax law allowed the IRS to collect more from disputes with taxpayers (discouraging tax evasion), and raised the incomes of tax professionals.⁶²

In 1996, Adrian Sawyer provided an extension of White's approach in which he discussed two additional economic complexity reactions.⁶³ The first of Sawyer's additions discussed the scenario in which increased complexity created increased perceived certainty of outcome, despite both sides considering it likely that the outcome will go in their favour. The second related to the scenario in which increased complexity resulted in both parties becoming less certain of the outcome.⁶⁴ Sawyer's work highlights the gulf which may exist between the perceptions of the parties to a tax dispute, and the legal reality.

Richardson and Sawyer in 2001 also presented a survey of the research into the effects of various factors on compliance behaviour. Noting the difficulty presented by the absence of an agreed definition among researchers (leading, importantly, in some studies to its operationalization as uncertainty regarding a taxpayer's true tax liability),⁶⁵ the authors argued that while the most frequent finding was that complexity had no effect on compliance behaviour, studies had also shown both a positive and negative relationship between the two. This tended toward the conclusion that the presence of complexity may impact upon compliance in a number of different ways.⁶⁶ Hence, while the implications of complexity within tax law are likely many and varied, it would seem at least arguable that its presence may create uncertainty, which may turn negatively impact upon taxpayer compliance, either by making it more difficult for taxpayers to comply, or else reducing the incentive to do so.

⁵⁹ At 139.

⁶⁰ Michelle J White "Why are Taxes so Complex and Who Benefits?" (1990) 16 April Tax Notes 341.

⁶¹ At 342.

⁶² At 342.

⁶³ Adrian Sawyer "Why are Taxes so Complex and Who Benefits: An Extension of White" (1996) 16 December Tax Notes 1337.

⁶⁴ At 1340.

⁶⁵ M Richardson and A Sawyer "A Taxonomy of the Tax Compliance Literature" (2001) 16 Australian Tax Forum 185.

⁶⁶ At 185.

The presence of uncertainty may also result in the creation of unintended incentives for risk seeking taxpayers to “sail close to the wind” in the hopes that their activities will not be detected. The risk averse taxpayer is, however, by nature, considerably less likely to engage in such behaviour with the consequence that the risk seeking taxpayer who goes uncaught will be better off than the taxpayer who is risk averse. As a result, the incidence of tax avoidance may increase, although it is, ironically, the very activity that uncertain devices such general anti-avoidance rules seek to deter.⁶⁷ Accordingly, there would seem to be an argument for the use of measures which decrease complexity, and promote certainty within a jurisdiction in order to encourage compliance and reduce the rate of tax avoidance.

5 *Impeding the Dispensation of Public Policy*

An uncertain fiscal environment may also carry with it implications for the administration of public policy. In this respect, it not unusual for governments to embed incentives or inducements within their tax law in order to encourage taxpayers to engage in behaviour which, for one reason or another, is considered socially desirable. Yet if there is uncertainty as to the extent to which such provisions can be relied upon then taxpayers may become reluctant to carry out transactions which engage these provisions and the dispensation of public policy may be impeded.

The existence of incentive provisions has been recognised in the decisions of the judiciary of the UK, Canada and New Zealand. For instance, in the UK House of Lords case of *Barclays v Mawson*,⁶⁸ Lord Nicholls of Birkenhead wrote that parliament at times provided “generous” initial allowances for depreciation on the value of the machinery or plant used by a trader which exceeded actual depreciation, as a “positive incentive” to invest in new plant.⁶⁹ In the Canadian Supreme Court case of *Stuart Investments v R*,⁷⁰ Estey J warned that a strict business purpose requirement would, in certain circumstances, run counter to the intent of the legislature owing to the “dual aspect” of modern taxing statutes; tax statutes were not only designed to raise revenue but were also employed by government to attain economic policy objectives.⁷¹ A business purpose requirement might prevent the taxpayer from engaging in the activity which Parliament had invited in an effort to attain economic and social policy goals.⁷²

⁶⁷ Taxation Committee of the New Zealand Law Society, the Corporate Taxpayers Group, and the Taxation Committee of the New Zealand Institute of Chartered Accountants *Report: Improving the operation of New Zealand's tax avoidance laws* (Auckland, 2011) at [2.49].

⁶⁸ *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] 1 AC 684.

⁶⁹ At [3] per Lord Nicholls of Birkenhead.

⁷⁰ *Stuart Investments Ltd v R* [1984] 10 DLR (4th) 1.

⁷¹ At [55] per Estey J.

⁷² At [55] per Estey J.

In the New Zealand Court of Appeal case of *Challenge v CIR*,⁷³ Richardson J held that the legislature could not have intended for New Zealand's then GAAR, s 99 of the Income Tax Act 1976, to override all the other provisions of the Act in such a way as to deprive taxpayers of "structural choices, economic incentives, exemptions, and allowances provided for by the Act itself."⁷⁴

Although the courts of the UK, Canada and New Zealand may accept that the legislature enacts incentives in the hope that a taxpayer may act in reliance upon them, the use of a judicial doctrine or GAAR can create significant confusion as to the extent to which taxpayers may take advantage of these provisions. For instance, in the Canadian case of *Canada Trustco Mortgage Co. v The Queen*,⁷⁵ the Supreme Court referenced the Explanatory Notes to Canada's GAAR, s 245 of the Income Tax Act 1985 in which it was stated that it was not intended that the tax incentives provided in the legislation be "neutralised" by the GAAR;⁷⁶ rather, the central question was whether the particular transaction frustrated the object, spirit or purpose of the provisions upon which the taxpayer relied.⁷⁷ Yet how is the taxpayer to know when his or her deeds will do exactly that? Similarly, in the New Zealand case of *Ben Nevis Forestry Ventures Ltd & Ors v CIR*⁷⁸ a majority of the Supreme Court held that while taxpayers had the freedom to utilise tax incentives in the manner in which the legislative text, read in the light of its context and purpose permitted, they could not do so in a way proscribed by New Zealand's GAAR, s BG 1 of the Income Tax Act 2007.⁷⁹ The difficulty with such a statement, however, is that a GAAR, strictly speaking, does not proscribe anything.

In essence, the use of a GAAR or a judicial doctrine may cast doubt upon the extent to which taxpayers may make use of the very provisions enacted in order to encourage behaviour which the legislature considers socially desirable. The efficient dispensation of public policy may therefore be inhibited.

H Fairness and Uncertainty: Associated Values?

Discussing the efficient administration of the tax system and the matter of taxpayer compliance, Kenneth Gideon in 1992 argued in favour of the increased use of "administrable rules." In the context of the tax system, Gideon gave these to mean rules that could be both understood by the taxpayers to whom they applied and able to be enforced by the US Internal

⁷³ *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513

⁷⁴ At 548 per Richardson J.

⁷⁵ *Canada Trustco Mortgage Co v R* 2005 SCC 54.

⁷⁶ At [48].

⁷⁷ At [59] per McLachlin CJC and Major J.

⁷⁸ *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC).

⁷⁹ At [111] per Tipping and McGrath JJ.

Revenue Service (IRS) with a minimum of dispute.⁸⁰ Successful, practical rules, had value not only for tax practitioners but also for tax legislators as they ultimately made it easier for taxpayers to comply with the demands of the legislation.⁸¹ Efforts aimed at conflict resolution through negotiation and litigation carried costs in the form of uncertainty, delay, and service fees. Turning to anti-abuse rules, Gideon maintained that where these were once regarded as a last ditch “hail Mary” they had become a first, rather than last line of defence. The basic defect of such rules, he reasoned, was their uncertainty. For Gideon, the argument that the vagueness inherent in anti-abuse rules was necessary to check aggressive tax practitioners reflected a confusion of priorities; the primary objective of a new tax rule was to provide clear answers to the compliant, rather than to apportion punishment to abusers.⁸²

Gideon contended that there was a “fundamental relationship” between transparency, simplicity and fairness. Clear rules, he wrote, tended to be simple ones which were less susceptible to creating within the taxpayer the fear and suspicion that the interpretation of a neighbour or fellow taxpayer was more favourable to his or her interests than his own.⁸³ Importantly, however, Gideon did not seek to imply that all anti-abuse rules, vague legislation, and imprecise court decisions were wrong, or that a tax system could be run without them. Rather, he argued, these ought to be recognised as the second (or more probably third) best solutions they were, and not as close substitutes for the creation of administrable rules which served to end controversy and provide certainty.⁸⁴

I Specific Rules, GAAR, and Judicial Doctrines

1 A Balancing Act?

What the preceding discussion would tend to indicate is that the question of which form of rule (i.e. general or specific) the legislature will deploy to address a given scenario may in many instances depend upon which values are considered by policy makers to underpin the tax system. The affection present within Smith’s work for the value of certainty would tend to suggest that the use of specific rules is for the most part to be preferred, as these offer taxpayers greater certainty as to how they may arrange their affairs. Where, however, the use of a general rule or principle is for some reason unavoidable, a second division emerges

⁸⁰ This the writer has understood to refer to clear, objectively certain provisions. See Kenneth Gideon “Assessing the Income Tax: Transparency, Simplicity, Fairness” (1999) 25 Ohio NUL Rev 101.

⁸¹ The benefit of such rules was their ability to be applied with a high degree of certainty that there would not be a large economic spread between the return positions of the taxpayer and the audit position of the Revenue. At 102.

⁸² In support of his argument, Gideon offered the example of the vague ‘smell’ tests which were deployed against individual tax shelters in the 1980s with little effect until the passive loss rules were enacted. At 107.

⁸³ At 112.

⁸⁴ At 106.

between the use of, on the one hand, a judicial doctrine, and on the other, a general rule. It is the writer's contention that the use of a judicial doctrine, owing chiefly to its cautious and incremental development at the hands of jurists, is more likely to be conducive to the promotion of certainty within a tax system than a general rule.

There is nonetheless a tension between the manner that the legislation is invoked by the collectors of revenue in support of its position and the approach taken to the same legislation by the courts. While taxpayers would doubtless prefer certainty and consistency across both, it is likely that most taxpayers, if forced to choose between the two, would elect for a greater level of certainty in the approach taken by the judiciary. Indeed, if the judicial approach to problems of tax avoidance was more consistent and predictable then the revenue would likely be forced to behave similarly (subject, perhaps, to the revenue's assessment of the likelihood the taxpayer will dispute the revenue's assessment before the courts).

2 *Jurisdictional Trends*

The UK is the only jurisdiction in the common law world to make sole use of (in addition to a myriad of specific provisions and a clearance regime) a judicial doctrine, as opposed to a GAAR, to deal with matters of tax avoidance. As the emphasis is on an examination of the specific instruments deployed in each jurisdiction and their respective implications for the value of certainty, limited attention is given to the role of the UK's clearance regime. This is not to say that the interaction and relationship between the UK's judicial doctrine and clearance regime does not merit attention, but rather that to do this is beyond the scope of this thesis.

The UK's sole use of a judicial doctrine is, however, in contrast to the observable deployment of a GAAR throughout the British Commonwealth.⁸⁵ Canada, for instance, operates what might be described as a potentially aggressive GAAR in the form of s 245 of the Canadian Income Tax Act 1985. Australia operates Part IVA of the Australian Income Tax Assessment Act 1936, while New Zealand makes use of s BG 1 of its Income Tax Act 2007.⁸⁶ Further afield, South Africa and Singapore also rely on the use of a general anti-avoidance rule (as does China, which has had such an instrument since 2008). Hong Kong is apparently unique

⁸⁵ The UK is, however, shortly to enact a GAAR in its Finance Bill 2013. This is discussed in Chapter Four.

⁸⁶ As noted a discussion of the New Zealand case of *Glenharrow Holdings Ltd v Commissioner of Inland Revenue (Glenharrow)* [2008] NZSC 116 has been omitted as it concerns Goods and Services Tax (GST) rather than income tax. It should be said, however, that the case of *Glenharrow* follows a similar approach to that set down in the case of *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC). There is also a material similarity between s 76 of the Goods and Services Tax Act 1985 and s BG 1 of the Income Tax Act 2007. Again, the extent to which the jurisprudence of s 76 and s BG 1 interacts with one another is a matter of debate.

in that it employs both a judicial doctrine and a GAAR to deal with tax avoidance.⁸⁷ Although India was rumored to be considering the introduction of a GAAR in April 2013 as part of its Union Budget 2012⁸⁸ it would seem that this has now been delayed until 2016, possibly in an effort to attract capital inflows.⁸⁹

J Findings and Conclusion

Owing at least in part due to the work of theorists such as Smith and Dicey, the value of certainty arguably came to occupy a place of particular importance within the countries of the British Commonwealth. While some commentators would argue that this remains the case still, there would seem to have been a shift in recent years away from the value of certainty toward broader, more egalitarian notions of equity. There would thus seem a measure of tension between the values of certainty and equity. A focus on giving effect to the latter may contribute to the creation of uncertainty within the tax law.

A climate of uncertainty may, however, carry with it a number of unintended consequences. The presence of uncertainty may risk inhibiting the prevalence of commerce within a jurisdiction by increasing compliance costs, as well as the incidence of capital flight and the utilization of asset sheltering devices. It may lead to an expansion of bureaucracy, a reduction in administrative efficiency, and act to inhibit the dispensation of public policy by casting doubt upon the extent to which incentives embedded in fiscal statutes may be relied upon. The presence of uncertainty may also make it difficult for taxpayers to comply with the demands of the Revenue, leading in some cases to the increased incidence of tax avoidance. Consequently, jurisdictions may find it beneficial to adopt measures designed to increase the level of certainty within their borders, if only out of self-interest.

The preceding represents but a brief foray into the value of certainty. Before embarking upon an examination of the case law of the UK, Canada and New Zealand, however, it would seem prudent to first consider the nature of the activity that the law would seek to prevent, and inquire into the concept of tax avoidance itself. Accordingly, it is to this matter that the writer would now turn.

⁸⁷ Michael Littlewood “The Legacy of UK Tax Law in Hong Kong” (2008) 3 BTR 253 at 254.

⁸⁸ PWC “Observations of the General-Anti Avoidance Rules in the Asia Pacific Region” (2012) Asia Pacific Tax Notes 2 at 2.

⁸⁹ Manoj Kumar “Controversial GAAR norms deferred to April 2016” (Reuters, January 2013) <in.reuters.com>.

III TAX AVOIDANCE – THEMES AND ISSUES

A Introduction

While tax avoidance is an activity of which a great many people would claim to disapprove, it is doubtful whether many of them would be able to advance a meaningful definition of its characteristics. The fault, however, if there is one, is not theirs necessarily. Indeed, one might even go so far as to say that tax avoidance cannot be properly defined.¹

B What is Tax Avoidance?

What therefore is tax avoidance? Certainly, tax avoidance differs from tax evasion. Where the former is technically legal, the latter is by contrast an act of fraud and a criminal offence.² Tax evasion generally involves a taxpayer acting with the intent of defrauding the collector of revenue of an obligation which has already arisen. Although there are cases of tax avoidance in which the taxpayer may be alleged to have acted with intent to deceive, these are rare.³ Tax avoidance, by contrast, may be understood as a course of action undertaken by the taxpayer which prevents a liability from ever arising.⁴

Even so, the exact nature of tax avoidance is the source of no small amount of contention. What may appear to one party to be merely the structuring of his or her affairs to their best advantage may seem to another as an act designed specifically with the intent of avoiding the imposition of liability. Thus, a course of action that may technically come within the rules of the tax code may be regarded by the collectors of revenue as an effort expressly aimed at defeating their intent. Hence, so far as definitions are concerned, there is a certain measure of subjective perception involved. Understandably, therefore, the formulation of a comprehensive definition of tax avoidance has proved elusive.

Commentators and academics have approached the matter differently. David Dunbar offered the view that tax avoidance was the unacceptable reduction of taxpayers' liability by means that the tax law was intended to cover, but for some reason did not.⁵ Another approach (as

¹ Michael Littlewood "Tax Avoidance, The Rule of Law and the New Zealand Supreme Court" [2011] NZ L Rev 35 at 36

² Former Chancellor of the Exchequer Dennis Healey once remarked that the difference between tax avoidance and tax evasion was the width of a prison wall. Alex Ruffel "Eight Tips to Beat the Taxman – Honestly" (Date Unknown) <www.telegraph.co.uk>.

³ Craig Elliffe "Tax Avoidance" in *New Zealand Taxation 2012 Principles, Cases and Questions* (Brookers, Thomson Reuters Wellington, 2013) at 1014.

⁴ At 1014.

⁵ David Dunbar, "Tax Avoidance: A Judicial or Legislative Solution; Lessons for the United States from the British Commonwealth" (2010) Nov CBTM 21 at 23.

Dunbar acknowledged), is to regard tax avoidance as the frustration of a legislative rule, as Lord Nolan did in *IRC v Willoughby*,⁶ in which his Lordship defined tax avoidance as a “course of action designed to conflict with or defeat the evident intention of Parliament.”⁷ Eugen Trombitas described tax avoidance as occurring where the letter of the law allowed tax savings which the policy of the law, based on the legislative scheme, did not.⁸ Lord Hoffmann held that a scheme designed to avoid the charge to tax may be without effect if, upon the true construction of the statute, it actually came within it.⁹ Craig Elliffe, writing in *New Zealand Taxation*, defined tax avoidance in terms of “artifice,” “contrivance” and a “distinct lack of commercial reality.”¹⁰

There is little doubt that amidst these varying definitions lies the consistent theme of “avoiding” or “dodging” an obligation. There is also, however, the undeniable sense that the writer has not quite defined or captured the essence of the activity which is supposedly the subject of prohibition. After all (likelihood of detection aside), if tax avoidance could be well defined, then there would be no cases of it, as taxpayers would know what to avoid doing in order to avoid being accused of having done it. None of these definitions, in other words, would seem particularly satisfactory.

What, for instance, did Lord Hoffmann mean in speaking of the “true construction” of a statute? What did Elliffe seek to indicate in enlisting the aid of the concepts of “artificiality” and “contrivance?” What these remarks suggest is that something more than the text of the statute is at issue in determining whether tax avoidance has occurred. Yet this is obviously problematic, for how is one to go about discerning the “intent” of the legislature if not with reference to the text of its enactments? The difficulty with these “explanations” is that they do not really address the concept of tax avoidance so much as describe the circumstances under which it may be said to have occurred with reference to a conceptual abstraction; the “policy” of the statute. Consequently, the focus of the enquiry is shifted from the characteristics of the “offence” (the avoidance of tax) to the content of the legislative policy which is said to underlie the fiscal statute in question. If one is to inquire into the nature of tax avoidance, then it would seem necessary to look further afield.

⁶ *Inland Revenue Commissioners v Willoughby* [1997] AC 1071 at 1079 per Lord Nolan.

⁷ Dunbar, above n 5, at 23.

⁸ Eugen Trombitas “The Conceptual Approach to Tax Avoidance in 21st Century: When the Statute Gives but GAAR can Take Away” 15 NZJTL 352.

⁹ See *Norgien Ltd (in Liq) v Reed Rains Prudential Ltd* [1999] 2 AC 1 at 13-14 per Lord Hoffmann.

¹⁰ Craig Elliffe “Tax Avoidance” in *New Zealand Taxation 2013 Principles, Cases and Questions* (Brookers, Wellington, 2013) at 1013.

C Conceptual Difficulties

The difficulties associated with tax avoidance do not end with an attempt to present a definition of its tenets. Indeed, there would seem to be a number of problems contained within the concept itself. Many of these were, in the writer's view, very ably articulated by Michael Trebilcock in an LLM thesis written at the University of Adelaide in the 1960s.¹¹ In it, Trebilcock considered s 260 (now replaced by Part IVA)¹² of the Australian Income Tax Assessment Act 1936,¹³ a general anti-avoidance rule designed to assist the courts in combating tax avoidance.¹⁴

Section 260 provided, in part, that any "contract, agreement, or arrangement" insofar "as it has or purports to have the purpose or effect in any way, directly or indirectly" of "defeating evading or avoiding any duty or liability imposed on any person by this Act" would be "absolutely void as against the Commissioner or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose."¹⁵ Trebilcock's central thesis was that s 260 displayed weaknesses which were not merely unique to that section but which were inherent in any general prohibition of "tax avoidance."¹⁶ Accordingly, he argued that any general prohibition of tax avoidance would exhibit a set of common conceptual defects from which no amendment could save it,¹⁷ and in the process provided several insights into why the formulation of a succinct definition of tax avoidance has proved so elusive.¹⁸ These matters are dealt with in the following paragraphs.

¹¹ The writer is greatly indebted to Benjamin Alarie for his clear elucidation of its tenets and also to the University of Adelaide for making a copy of Trebilcock's thesis available to him. The writer has been unable to locate any criticism of Trebilcock's work on this point.

¹² Section 260 of the Australian Income Tax was replaced by Part IVA in 1981 with respect to scheme entered into or carried out after 27 May 1981. Australian Taxation Office "Part IVA of the Income Tax Assessment Act 1936 commentary on key issues" <www.ato.gov.au>.

¹³ See M.J. Trebilcock "Section 260 of the Income Tax Assessment Act: A Study in the Combating of Tax Avoidance" (LLM Thesis, University of Adelaide, 1964).

¹⁴ Benjamin Alarie "Trebilcock on Tax Avoidance" (2010) UTLJ 623.

¹⁵ At 631.

¹⁶ At 631.

¹⁷ At 632.

¹⁸ It is also worth noting the similarities between Trebilcock's approach and that of Michael Littlewood, who reached similar conclusions in his examination of s BG 1 of the New Zealand Income Tax Act 2007. See Littlewood, above n 1.

D The Assumptions Underlying Tax Avoidance: The Views of Michael Trebilcock

1 What Constitutes the Avoidance of Liability to Tax?

An important element present within the concept of tax avoidance is the avoidance of a liability. Yet there are problems associated with defining the nature of the liability itself. In this respect, Trebilcock argued that in seeking to prohibit tax avoidance, a general anti-avoidance rule seeks to present an answer to the question “when has an arrangement the purpose or effect of avoiding liability to tax?” Or, alternately, “what constitutes the avoidance of liability to tax?” The difficulty with such a question, however, is that once tax liability has been incurred by the taxpayer, it cannot, by private bargaining or otherwise, be displaced. Such a liability, having once arisen, is fixed and inviolable.¹⁹ Thus, the target of the GAAR must be any arrangement which sidesteps tax liability before it “crystallises.” Tax avoidance can therefore be understood as behaviour which results in the avoidance of a liability that is inchoate, or in other words, has yet to arise.²⁰ Section 260, in his view, was therefore to be taken as striking at arrangements that had the effect of preventing a liability from coming into existence, and did not answer the question of “what constitutes the avoidance of liability to tax” but rather posed the further question of “when has an arrangement prevented a liability from arising?” In Trebilcock’s view, however, no future liability to tax could be regarded as strictly inevitable.²¹

In aid of his argument, Trebilcock gave the example of the taxpayer who chose not to work overtime on the grounds that to do so would result in the additional hours worked being taxed at a higher rate. In such a case, the taxpayer has avoided a liability to tax which, but for his or her behaviour, would have been incurred. Yet to insist that the taxpayer pay tax at the higher rate would be akin to the imposition of a tax on the consumption of leisure, and obviously absurd.²² Would the legislature really seek to penalise leisure? Indeed, the very notion would appear coercive. Further categorisation would therefore seem necessary. This led Trebilcock to discern the need to distinguish between instances of tax avoidance that were “objectionable” and those which were “unobjectionable.”

¹⁹ Alarie, above n 14, at 633.

²⁰ At 633.

²¹ This, in the writer’s view should be taken to indicate that in presenting a finding of liability either the courts lay claim to an impossible level of knowledge in respect of the taxpayer’s actions in the alternative, or else coercively impose their will upon the taxpayer. In imposing liability based upon a conception of the route not taken, the courts would claim to be able to discern how the taxpayer would have behaved in the alternative, notwithstanding that this might in fact to have been to “do nothing.” If, however, the courts are unable to know how the taxpayer would have behaved in the alternative, then it would seem only logical that the courts make a decision on the taxpayer’s behalf, raising the prospect of coercion.

²² Alarie, above n 14, at 633.

1 *The Thorny Notion of Legislative Intent*

To regard a GAAR as having application whenever a taxpayer was lured into a certain transaction would be absurd. If applied without conditions, s 260 would likely deprive any number of specific provisions (such as those creating deductions, for example) of any effect.²³ Efforts to deal with tax avoidance must necessarily enlist some idea of what the statute will permit; in other words, a concept of the consequences contemplated by the statute. Yet this presents difficulties, as tax legislation often pursues several policy ends at the same time,²⁴ thus any attempt to select between these ends would require knowledge of the mind of the legislature. However, Trebilcock regarded this as a “slippery fiction.”²⁵ In his words:²⁶

...if the courts in determining whether a particular instance of tax avoidance is or is not objectionable under s. 260 cannot refer to what the legislature contemplates in this circumstance, it must follow that in making this distinction, the courts in fact apply their own criteria for determining when a taxpayer has avoided a liability to tax which he ought properly to have incurred. This extra-statutory ‘ought’ inherent in the concept of tax avoidance and in the absence of a statutory definition of the expression must remain an entirely subjective concept – the concept of a proper liability to tax which a man should not be allowed to avoid...

Indeed, as he went on to inquire, how is a court to reconstruct the purpose and intent underlying a text that has been voted upon, passed and amended over the years? Not all legislators are likely to have a full understanding of the provisions which they are voting upon, nor is this understanding likely to be uniform amongst a majority of legislators. Any effort to impute a singular will or consciousness to an institution such as the legislature is therefore inherently problematic. If, however, a scrutiny of the intent of the legislature is likely to prove unproductive, then perhaps the focus should turn to the motivations of the taxpayer instead. Yet even this Trebilcock was inclined to view with disfavour.

2 *The Motivations of the Taxpayer*

The idea of focusing on the motivations of the taxpayer was adopted by the Privy Council in *Newton v Federal Commissioner of Taxation (Newton)*.²⁷ The predication test, as it came to be called, was coined by Lord Denning in an effort to distinguish between permissible and impermissible conduct on the part of taxpayers. This was given as applying to tax avoidance

²³ At 634.

²⁴ At 634.

²⁵ At 634.

²⁶ At 635.

²⁷ *Newton v Federal Commissioner of Taxation* [1958] AC 450 (PC).

conduct where “it is possible to predicate by reference to the overt acts by which it was implemented that its purpose was the avoidance of tax, being not explicable as ‘an ordinary business or family dealing.’”²⁸

Trebilcock’s objection to this approach, however, was directed at the difficult, if at all present, distinction between business or family dealings that were “ordinary” and those which were, by contrast, presumably “extraordinary.” As he inquired: ²⁹

What is an ‘ordinary’ business or family dealing? The combination of circumstances which may comprise a business or family dealing is infinite. It is impossible to characterise any one combination or class of circumstances as ordinary and all others as extraordinary. It does not follow that a dealing which has the effect of avoiding tax and which is extraordinary in some way must inevitably as a matter of logic, have a purpose of avoiding tax. It is one thing to say that a dealing is extraordinary; it is quite another to say that it has the purpose of avoiding tax.

This exposes two difficulties; first, that which arises in respect of attempts to classify a form of dealing as either “ordinary” or “extraordinary.” Any attempt on the part of a court to distinguish between dealings of the “ordinary” business or family variety is limited by the extent to which it can recognise the characteristics of each. Where the dividing line lies and how it is to be perceived is a matter of some uncertainty. Second, there is the risk of confusing the purpose for which the taxpayer entered into an arrangement with its effect. Indeed, merely that a form of dealing may be regarded as “extraordinary” does not mean that the taxpayer entered into it for the purpose of avoiding liability to tax.

Trebilcock’s work presents a number of important themes, and it is these, along with those articulated by Joel Nitikman and Michael Littlewood that, in the author’s view, best shed light upon the problems which underlie a declaration of tax avoidance on the part of a court. However, some summation and development of the preceding ideas would seem necessary.

E In Summation: Is Tax Avoidance an Inherently Speculative Proposition?

1 Tax Avoidance

For a court to say that a taxpayer has “avoided” tax implies that it regards him or her as having engaged in a form of dealing without regard for the court’s preferred alternative (which was, at the time, perhaps unknown to the taxpayer). In avoiding or nullifying the “offending” arrangement or transaction, it might be said that the court deprives the taxpayer of the fruit of his or her labour. Likewise, in rewriting or “reconstructing” the transaction, it

²⁸ Alarie, above n 14, at 635.

²⁹ At 637.

might be contended the court either lays claim to an impossible level of knowledge as to how the taxpayer might have acted in the alternative (which is, in practice, rarely or if ever held to be “to have done nothing”), or else retrospectively enquires into his or her business dealings and imposes its will upon the taxpayer.

2 *The Will of the Legislature*

(a) Defining the Concept

To argue that the taxpayer’s use of a provision has not come within its purpose is problematic. The reason this is so is that it presupposes that there somewhere exists a consistent and discernible representation of the will and intent of the legislature. This is, after all, a body whose composition alters with each term of office and which is itself for the most part no more unified than a voting majority (unanimity being exceedingly rare) of the representatives which comprise it. Each of these will likely understand the legislation upon which they are voting differently (which may in many cases mean incompletely or inaccurately, as a survey of *Hansard* can often indicate).³⁰ After all, politicians, despite officially holding office as representatives of the electorate, are to an extent beholden to the advice of bureaucrats. This is particularly so where technical matters (such as those presented by tax law) are concerned; it is therefore unlikely that there will be a common or shared understanding among the representatives of the electorate as to the central tenets or purpose of the fiscal legislation upon which they are voting.

This suggests that the recourse to the notion of the “will of the legislature” presents a number of difficulties which are perhaps particularly prominent in the context of tax avoidance, where the imposition of fiscal liability is concerned.³¹ Trebilcock’s description of the concept as a “slippery fiction” bears similarities to the sentiments expressed by Professor Vern Krishna. Discussing the application of Canada’s GAAR in the Supreme Court case of *Lipson v Canada*,³² Krishna wrote of the concept of legislative intention as a “myth,” albeit a necessary one, in the field of statutory interpretation.³³ While the legislator rarely had any defined or clear intent on complex statutory provisions in income tax law, it was nevertheless

³⁰ Jonathan Levy and Adam Craggs “Tax Avoidance for High Net Worth Individuals – Where are we Now?” 1 PCB 2011 48 at 48.

³¹ As Trebilcock opined: “...if the courts in determining whether a particular instance of tax avoidance is or is not objectionable under s. 260 cannot refer to what the legislature contemplates in this circumstance, it must follow that in making this distinction, the courts in fact apply their own criteria for determining when a taxpayer has avoided a liability to tax which he ought properly to have incurred.” See Alarie, above n 14, at 635.

³² *Lipson v R* 2009 SCC 1.

³³ Vern Krishna “GAAR Trumps Westminster in *Lipson*” (2009) (19)8 Canadian Current Tax 85 at 88.

necessary to ascribe a rational purpose and intent to all legislation. Thus, Krishna wrote, legislative intention was extracted from “all credible and reliable extrinsic evidence.”³⁴

Yet any attempt to extract legislative intention from extrinsic evidence is, for the taxpayer, an inherently problematic exercise. How is it, for instance, that the product of all due diligence and the best professional advice available may nonetheless be regarded as tax avoidance by the courts? Is the will of the legislature capable of being discerned only by jurists? Even these are by no means infallible; consider the instances in which judicial opinion is split, or where decisions are overruled. In such a case, how is one to know which jurist has declared the will of the legislature best?³⁵

It must be emphasised that this is not to say that the enlistment of the notion of legislative intent is wrong, or that statutory interpretation should be rigidly formalistic;³⁶ indeed, Krishna’s characterisation of the concept of legislative intent as a “necessary myth” offers pause for thought. Rather, the implication of the preceding discussion is simply that the concept of legislative intent rests on a number of assumptions which may carry implications for the value of certainty in tax law. Accordingly, it should therefore be deployed with care and caution if the value of certainty is to be preserved.

(b) The Notion of Intent and the Operation of Arrangements

In addition to the concept of legislative intent, there is also the matter of “functionality” to consider; or in other words, what causes arrangements to operate such as to have “tax effect?” Applying the purposive approach, in the event that a taxpayer’s use of a provision extends beyond the object or spirit of the statute upon which he or she has relied, it would seem in keeping with principle for a court to declare the arrangement “dysfunctional,” “inoperative” or void *ab initio*; in other words, without “tax effect.” Enlist the aid of a GAAR, however, and matters become rather more complex. As Joel Nitikman, writing on the subject of Canada’s GAAR, s 245, wrote:³⁷

One does not ‘misuse’ a provision by failing to come within its object and spirit. *Failing to come within the provision as interpreted with the aid of the object and spirit simply means that the taxpayer has failed to qualify for the tax benefits sought to be achieved, regardless of [sic] GAAR.*

³⁴ At 88.

³⁵ It must be emphasised that this criticism is directed not so much at the efforts of jurists to resolve ambiguity or the reconciliation of apparently competing provisions but rather at instances in which the courts determine that the taxpayer does not qualify for a deduction or exemption despite on the face of it apparently coming within the plain language of the applicable section.

³⁶ Indeed, the writer for his part would by no means wish for the development of tax law to be constrained or shackled by an uncompromising literalism.

³⁷ Joel Nitikman “Is GAAR Void for Vagueness” (1989) 37(6) Can Tax J Rev Fiscale Can 1409 at 1442 (emphasis added).

Following the Canadian cases of *Mathew v the Queen*³⁸ and *Mortgage Co. v The Queen*,³⁹ Federico Raffaele opined to similar effect:⁴⁰

If...the Court's position is that all statutes must be interpreted textually, contextually, and purposively, then the question moves to the relevance of the GAAR. Presumably, if the provisions of the Act are interpreted according to the modern rule, they will not apply to transactions that are abusive of the statutory scheme or purpose and therefore the GAAR is unnecessary.

The essential point is that the use of a GAAR in conjunction with the purposive approach risks presenting a contradiction in terms. After all, if a transaction cannot rely upon the provisions which it enlists in aid of its operations, then it can no more have tax effect than a car without an engine can be said to be capable of propelling itself. Yet the use of a GAAR would appear to assume that, despite the transaction falling outside the purpose of the specific provision upon which it would purport to rely, it may “operate” such as produce a “tax benefit” which a GAAR may be then enlisted to invalidate.⁴¹ Yet how can this be? Is this not tantamount to suggesting that a corpse may be deprived of life? The inconsistency is troubling. Does this suggest that the legislature may intend for a transaction to have tax effect simply for the purpose of being disallowed by a general anti-avoidance rule? Surely not; for this would suggest that the will of the legislature is at odds with itself. Is it rather that the purposive approach is applied inconsistently? This too, would seem contrary to principle. While there would appear to be few clear answers, the presence of such a dilemma is indeed problematic for the maintenance of a consistent approach to statutory construction.

3 “Ordinary” Forms of Dealing

Efforts to focus on the motivations of the taxpayer and to distinguish between “ordinary” and “extraordinary” forms of dealing also present difficulties, particularly as it is unclear how it is imagined that the parameters of these categories are to be determined. Yet even supposing that a court were to be able to categorise a form of dealing as “extraordinary” it is by no means certain that it was entered into for the purpose of avoiding tax. Accordingly, the risk of confusing the purpose for which a transaction was entered into with its effect is a recurring theme within discussions of tax avoidance.

In this respect, the courts have generally sought to avoid an inquiry into the subjective state of mind of the taxpayer, and instead focus on the “purpose” of the transaction itself. This is,

³⁸ *Mathew v. R.* 2005 SCC 55.

³⁹ *Canada Trustco Mortgage Co v R* 2005 SCC 54.

⁴⁰ Federico Raffaele, “From Westminster to Lipson: What Canada has done for Eighty Years to Counteract Tax Avoidance” (2009) 3 *Diritto e Pratica Tributaria Internazionale* 1205 (emphasis added).

⁴¹ Nitikman, above n 37.

however, highly problematic, because as Michael Littlewood has noted, a transaction is an inanimate device, itself devoid of consciousness.⁴² How then is its purpose to be inferred? The answer is, in all likelihood, to be with reference to its tax effect, which simply presents the same problem in new terms.

F The Choice Principle: An Illustration?

In an effort to avoid the absurd consequences that would follow were all forms of “tax avoidance” to be treated alike, the courts have often interpreted GAARs on the basis of the “choice” principle. This principle essentially maintains that the legislature could not have intended for taxpayers be deprived of all tax beneficial choices, inducements or incentives contained within fiscal legislation, and that, accordingly, to act in reliance upon them is not to act in contravention of, but to give effect to, the intent of the legislature.⁴³

In this respect, Littlewood, in a forthcoming article,⁴⁴ gave the New Zealand example of the rules contained in the Income Tax Act 2007 which provide for Portfolio Investment Entities (PIEs). As Littlewood explained, Parliament’s intention in enacting these rules was to encourage some forms of investment over others by taxing those which it preferred at the lower rate of 28 percent, rather than 33 percent. Obviously, it would be absurd to regard paying tax at the preferential rate as tax avoidance.⁴⁵

Concerning the choice principle, however, there is nonetheless still some doubt as to the extent to which the taxpayer may act in reliance upon its application. In Littlewood’s view, much would depend on how an investment was arranged; merely the fact that an investment complied with the requirements of the PIE scheme did not mean that it could not be characterised as tax avoidance. Investments were still to be structured in a “straightforward” way, and not in an “artificial or contrived manner.”⁴⁶

The problem with this approach, however, is that it essentially represents the deployment of the notions of “objectionable/unobjectionable” tax avoidance with recourse to the notion of legislative intent to distinguish between the two. This presents a curiosity, for so far as the PIE scheme is concerned a finding of “tax avoidance” represents an exception to the

⁴² Littlewood, above n 1 at 53.

⁴³ The “choice” principle might even be said to represent the sum, or culmination of Trebilcock’s fears. Viewed through the prism of his analysis, a transaction validated by the choice principle might be characterised as an “unobjectionable” form of tax avoidance falling within the intent of the legislature, carried out by the taxpayer for (or alternatively, containing itself) a “proper” purpose.

⁴⁴ Michael Littlewood “The Possibility of Amending New Zealand’s General Anti-Avoidance Rule” NZULR (2013) (Forthcoming).

⁴⁵ At 6.

⁴⁶ At 6,7.

application of the choice principle, which is itself an exception to the application of New Zealand's GAAR. Not only does this raise the prospect of an infinite regress, but it also makes it difficult to discern any rationale or standard by which the courts make and discard exceptions. Greater clarity, in other words, is desperately required if the value of certainty is to be preserved.

G Conclusion

The concept of tax avoidance and the methods employed by the courts in discerning its presence would seem to present a number of conceptual difficulties which carry implications for the value of certainty within tax law. While this is not to advocate a return to an era of rigid and uncompromising legal formalism, it would tend to suggest that a cautious approach is necessary if the value of certainty is to be respected. The alternative would risk placing undue strain upon the judiciary, in the process removing from the legislature the incentive to produce clear and consistent legislation. The production of inconsistent and unpredictable case law may follow, culminating in the imposition of tax on an arbitrary and inconsistent basis. In this respect, the concerns of Smith, Dicey and Hayek may have relevance still.

The following Chapters represent a survey of the approaches of the jurisdictions of the UK, Canada and New Zealand to dealing with the problem of tax avoidance. The central focus is the discernment of common themes within and among these jurisdictions and their implications for the value of certainty within tax law. The findings arising from these Chapters are the subject of further discussion in Chapter Seven.

IV THE UNITED KINGDOM

A Introduction

1 The Age of Formalism

The approach of the courts of the United Kingdom to cases involving tax avoidance was once quite different to what it is in the present day. In earlier times the courts took what might be described in modern language as a “strict,” “formalistic” or “legalistic” approach to statutory construction. This was well encapsulated in the pronouncement of Lord Halsbury in the case of *Bradford v Pickles* to the effect that the matter of motive was irrelevant to whether the subject had the lawful right to behave as he or she did.¹ As a consequence, while in the UK the onus of contesting the revenue’s assessment lies with the taxpayer,² fiscal legislation has often been applied conservatively. Lord Cairns, for instance, in the case of *Partington v Attorney-General* took the view that form, in fiscal cases, was “amply sufficient.” The person was only taxable if he or she could be brought within the letter of the law. An “equitable construction” was not admissible to a taxing statute.³ This cautious approach to the interpretation of fiscal legislation on the part of the judiciary persisted for some years until subsequent events altered the approach of the UK courts significantly.

2 Order of Procession

This Chapter seeks to discuss the UK position in relation to the law of tax avoidance. It begins first with the *Duke of Westminster*,⁴ before attention is turned to the reforming “triumvirate” of *Ramsay*,⁵ *Burmah*,⁶ and *Furniss v Dawson*.⁷ This is followed by a review of *Craven v White*,⁸ *Ensign Tankers*,⁹ *McGuckian*,¹⁰ and *Westmoreland Investments*.¹¹ After a brief discussion of these developments, attention is then turned to the cases of *Barclays*¹² and *Scottish Provident*.¹³ A consideration of the cases of *Tower MCashback*¹⁴ and *Mayes*¹⁵

¹ *Bradford Corporation v Pickles* [1895] AC 587 at 594 per Lord Halsbury.

² See 50(6) of the Taxes Management Act 1970.

³ *Partington v Attorney-General* (1869-70) LR 4 HL 100 at 122 per Lord Cairns.

⁴ *Commissioners of Inland Revenue v His Grace The Duke of Westminster* AC 1936.

⁵ *W T Ramsay v IRC* [1982] AC 300.

⁶ *Inland Revenue v Burmah Oil Co Ltd* [1982] SC (HL) 114

⁷ *Furniss v Dawson* [1984] AC 474.

⁸ *Craven v White* [1989] AC 398.

⁹ *Ensign Tankers Ltd (Leasing) v Stokes (Inspector of Taxes)* [1992] 1 AC 655.

¹⁰ *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991.

¹¹ *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311.

¹² *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] 1 AC 684.

¹³ *Scottish Provident Institution v Inland Revenue Commissioners* [2004] 1 WLR 3172.

follows. Time is then dedicated to the UK's plans to enact a statutory GAAR, in addition to a brief inspection of the instrument itself. The Chapter concludes with postulations as to the likely future direction of the UK.

B The Advent of The Duke of Westminster

The case of *The Commissioners of Inland Revenue v His Grace the Duke of Westminster (The Duke of Westminster)*¹⁶ is perhaps the most famous tax case to have ever been decided by a UK court, and represents the high watermark of legal formalism in UK tax law.

1 The Duke of Westminster: The Facts

The Duke of Westminster was one of the wealthiest men in England, and like many of his social standing, possessed a number of country estates. To care for these, his Grace employed a number of servants and retainers, the range of which was said to span “from gardener to laundryman to architect,” to carry out maintenance and repairs upon his holdings.¹⁷

The payment of his servants' wages, however, caused the Duke to incur liability to surtax. In order to avoid this tax, his Grace contrived an alternative scheme under which he reached with his servants the understanding that rather than keeping matters as they were, he would instead pay to each servant, in part satisfaction of his wages, an annuity for a period of seven years.¹⁸ The Deed to this agreement provided that the servant was entitled to receive weekly payments for which he was “not bound to do a stroke of work.”¹⁹ In addition, the Deed also provided that in the event the servant should render any future service to the Duke, he would be legally entitled to claim remuneration for that service over and above the payments under the deed without prejudice to his remuneration for future services.²⁰ Contained, however, within the correspondence between his Grace and his servants was the expression of hope or anticipation that the covenantee “[would] not enforce his legal right to remuneration for future services beyond a certain amount.”²¹

¹⁴ *Commissioners for Her Majesty's Revenue and Customs v Tower MCashback LLP 1 and another* [2011] UKSC 19.

¹⁵ *The Commissioners for HM Revenue & Customs v David Mayes* [2011] STC 1269.

¹⁶ *Commissioners of Inland Revenue v His Grace The Duke of Westminster* AC 1936.

¹⁷ *Duke of Westminster*, above n 16, at 7 per Lord Atkin.

¹⁸ At 17 per Lord Tomlin.

¹⁹ At 22 per Lord Russell.

²⁰ At 22 per Lord Russell.

²¹ At 22, 23 per Lord Russell.

The effect of this arrangement was to enable the Duke to deduct from his liability to tax the payments made to his servants by way of an annuity.²² The Commissioners of Inland Revenue, however, regarded the payments under the deed as in effect payments for services rendered and not allowable as deductions from his income.²³ Although the lower Court initially denied the Duke's appeal, this decision was overturned by the Court of Appeal, and eventually reached the House of Lords, where a majority upheld the judgment of the Court of Appeal (Lord Atkin dissenting), and ruled in the Duke's favour.

2 *The Decision of the Majority*

The essence of the Revenue's contention was that the payments made under the Deed were "in substance" payments for continuing service which were ejusdem generis with wages or salaries, and not annual payments able "properly to be deducted" from the Duke's assessment to surtax. A majority of the House of Lords was not, however, convinced by this argument. In response to the proposition that there was in revenue cases a doctrine that the Court might ignore the legal position and have regard to "the substance of the matter," Lord Tomlin argued that the sooner this misunderstanding was dispelled the better, as it seemed to involve "substituting 'the uncertain and crooked cord of discretion' for 'the golden and straight metwand of the law.'"²⁴ His Lordship then went on to give what is more or less universally regarded as "*The Duke of Westminster Principle*."²⁵

Every man is entitled if can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

In a similar manner, Lord Russell of Killowen held that to look at the substance of the matter meant that the true legal position was disregarded and a "different legal right and liability" substituted in place of that which had been created by the parties. The subject, his Lordship held, was neither taxable "by inference or by analogy" but rather "only by the plain words of a statute applicable to the facts and circumstances of his case."²⁶

²² Assaf Likhovski "The Duke and the Lady: *Helvering v Gregory* and the History of Tax Avoidance Adjudication" (2003-2004) 25 Cardozo L Rev 953 at 963.

²³ *Duke of Westminster*, above n 16, at 5, 6.

²⁴ At 19 per Lord Tomlin.

²⁵ At 19, 20 per Lord Tomlin.

²⁶ At 24 per Lord Russell.

3 Lord Atkin's Dissent

While the majority of the House of Lords may have accepted the arrangement between the Duke and his staff as being characterised by an annuity and the payment of half wages, Lord Atkin did not. His Lordship, dissenting, argued that this arrangement would render the Duke liable to pay the contractual wages of his staff in arrears, a sum equal to the payment under the deed. This, in his Lordship's view, would be a debt due to the servant capable of being attached by any creditor of the servant, and on his death would be assets which his personal representative would be "bound to recover."²⁷

Compelling though Lord Atkin's reasoning may have been, it was not the argument that won the day. Instead, it was the majority view that would shape the direction of tax law within the UK and the British Commonwealth for almost half a century.

C The Triune Principles of *The Duke of Westminster*?

What principles may be extracted from *The Duke of Westminster*? Alexander Chan, while a student at the University of Waterloo, offered several comments on the matter in response to what he perceived to be an insufficiency of scholarship on the subject.²⁸ Chan argued that *The Duke of Westminster* stood for three principles; first, a rejection of the economic substance doctrine, second for the principle that the statute shall not apply unless the taxpayer is caught under its letter,²⁹ and third, the rejection of the business purpose test.³⁰ Whatever *The Duke of Westminster* might once have stood for, however, has almost certainly been eroded by subsequent developments in the UK's case law, particularly the case of *Ramsay*.

D Along Came Ramsay

While *The Duke of Westminster* Principle managed to endure as an integral part of tax jurisprudence for approximately half a century, there were signs that its scope was becoming reduced by the courts. Whatever unease taxpayers might have felt, however, it was not until the arrival of the House of Lords decision in *WT Ramsay Ltd v IRC (Ramsay)*³¹ that its death knell came to be sounded.

²⁷ At 10 per Lord Atkin dissenting.

²⁸ Alexander Chan "Dealing with the Death of a Duke: The Need to Limit the Economic Substance Principle in Canadian Tax Law" (MTAX Research Paper, University of Waterloo, 2007).

²⁹ Chan stated his second principle as "if a taxpayer is not caught under the letter of the statute, then that statute shall not apply." At 6.

³⁰ At 4 – 8.

³¹ *WT Ramsay v IRC* [1982] AC 300.

1 *Ramsay: The Facts*

The facts of *Ramsay* involved a taxpayer company which farmed land in Lincolnshire. In 1973 it sold the freehold of the farm and realised a chargeable gain of £187,977. In an effort to reduce the amount of capital gains tax payable, it entered into a scheme designed to create artificial capital losses on share transactions which could in turn be offset against chargeable gains. The scheme itself involved the taxpayer company purchasing 68 shares in C Ltd, a newly formed investment company at a premium of £2,719 per share (£5 of which was payable on application, the balance on call). Simultaneously, the taxpayer company entered into a loan agreement under which it made two loans of £218,750 each (L1 and L2) to C Ltd for the terms of 30 and 31 years, respectively. Each loan was lent at the annual interest rate of 11 percent. The following month, the interest rate on L1 was reduced to zero, while that on L2 was increased to 22 percent. C Ltd called upon the taxpayer company to pay the balance of £184,654 owing on the 68 shares. The taxpayer company then sold L2 to a finance company, M Ltd, at its market value of approximately £393,750.

The scheme sought to ensure that the profit to the taxpayer company on the sale of that loan would be exempted from giving rise to a chargeable gain due to the provisions of paragraph 11 of Schedule 7 of the Finance Act 1965. Following further loan and share transactions between the parties, C Ltd was wound up. L1 became repayable to the taxpayer company at par. L2, however, had been assigned by M Ltd to an investment that was wholly owned by C Ltd and was repayable at the price of £394,673. These transactions acted to reduce the value of the shares of C Ltd, resulting in an artificial loss being accrued by the taxpayer company. The taxpayer was assessed to corporation tax in respect of the chargeable gains of approximately £176,552 arising from the sale of the farm for the accounting period ended May 1973.

On appeal against assessment, the Special Commissioners found the loans were “loan stock or similar security” of C Ltd within paragraph 5(3)(b). As L2 was a “debt on a security” within paragraph 11 of schedule 7, a chargeable gain accrued on the disposal of L2 by the taxpayer company. The lower Court allowed the taxpayer’s appeal on the grounds that L2 did not fall within the meaning of a “debt on a security,” with the consequence that no chargeable gain accrued on its disposal. Although the initial decision went in the taxpayer’s favour,³² this finding was, however, overturned by the Court of Appeal.³³ The House of Lords dismissed the taxpayer’s appeal.

³² *W T Ramsay Ltd v Inland Revenue Commissioners* [1978] 1 WLR 1313.

³³ *W T Ramsay Ltd v Inland Revenue Commissioners* [1979] 1 WLR 974.

2 *The Decision of the House of Lords*

The House of Lords took the view that the loan transactions cancelled one another out. This left the actual chargeable gain which their Lordships regarded as attracting tax liability. In essence, their Lordships held that a court might disregard steps inserted within a preordained transaction or series of transactions for no commercial purpose other than tax avoidance and apply the relevant statutory provision to the “end result.”³⁴ Lord Wilberforce, while describing the principle set out in *The Duke of Westminster* as “cardinal,” warned against allowing it to be “overstated or overextended.” Although this obliged the courts to accept genuine transactions, it did not compel them look at these in “blinkers,” or in isolation from any context to which it properly belonged. If it could be seen that a document or transaction was intended to have effect as part of a series of transactions then, his Lordship said, there was nothing to prevent it being regarded in this manner. To do so was to neither “prefer form to substance, or substance to form.”³⁵ Capital gains tax was created to operate in the real world rather than that of “make belief.”

Where *The Duke of Westminster* Principle had once afforded taxpayers something approaching carte blanche in choosing how to arrange their affairs, the advent of *Ramsay* served to significantly narrow the discretion which the courts would afford the taxpayer. It was a trend that would continue.

E Further Inroads into The Duke of Westminster Principle: IRC v Burmah Oil

The next most significant case to concern the *Ramsay* principle was *IRC v Burmah Oil Co (Burmah)*.³⁶ This developed the doctrine further, and is the second in the reforming “triumvirate” of *Ramsay*, *Burmah*, and *Furniss*.

1 Burmah Oil: The Facts

The facts of *Burmah* concerned an insolvent company, H, which owed a substantial unsecured debt to the parent company, B, which held all but one of the issued shares in H. As the debt was not an allowable loss in assessing capital gains for corporation tax purposes, a scheme was devised whereby the debt might be converted into a loss on realisation of the shares in H following its liquidation. To do so, B loaned exactly the amount of the debt owed by H to M (a subsidiary of B), which in turn lent the money to H. H repaid the debt it owed to B. H then made a rights issue of shares, which B took up at its full quota at a price equal to the amount of the loan. This resulted in the elimination of all debts and H being made

³⁴ Andrew Halkyard “Common Law and Tax Avoidance: Back to the Future?” (2004) 14 Revenue LJ 19 at 19.

³⁵ *Ramsay*, above n 31, at 323 per Lord Wilberforce (emphasis added).

³⁶ *Inland Revenue v Burmah Oil Co Ltd* [1982] SC (HL) 114.

solvent. H was then liquidated. The issue was whether B was allowed to deduct the issue price of the new shares in H.

Before the Special Commissioners of Inland Revenue, the matter at issue was whether the shares received on the rights issue were an independent asset acquired otherwise than by way of bargain made at arm's length for the purposes of s 22(4) of the Finance Act 1965. If so, the calculation was to be based on value rather than price. The Special Commissioners determined the matter in favour of B. The Commissioners of Inland Revenue's appeal to the Court of Session was refused by the First Division.³⁷ The House of Lords, however, ruled in favour of the Commissioners.³⁸

2 *The Decision of the House of Lords*

Lord Diplock held that the *Ramsay* approach entitled the House of Lords to ignore the circular book entries and look to the end result; the real loss which *Burmah* had sustained was of a debt not on a security.³⁹ As to *Ramsay* principle itself, Lord Diplock held that it would "disingenuous to suggest" that *Ramsay* "did not mark a significant change" in the approach taken by the House of Lords in its judicial role to a "pre-ordained series of transactions" into which were there were inserted "steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable".⁴⁰

Lord Fraser expressed the view that if the argument for *Burmah* was correct, it would represent another case in which "the taxpayer had achieved the apparently magical result of creating a tax loss that was not a real loss." As in *Ramsay*, there had been no loss in the sense which the legislation contemplated.⁴¹ Following the rulings in *Ramsay* and *Burmah* it was becoming increasingly apparent that the circumstances under which the taxpayer could claim the benefit of *The Duke of Westminster* Principle had been much reduced. The next decision of the House of Lords made this plainer still.

F *The Case of Furniss v Dawson*

The case of *Burmah* was shortly followed by *Furniss v Dawson* (*Furniss*).⁴² This case completes the reforming trinity of earlier English tax decisions.

³⁷ *Inland Revenue Commissioners v Burmah Oil Co Ltd* [1980] STC 731.

³⁸ *Burmah*, above n 36.

³⁹ At 125 per Lord Diplock.

⁴⁰ At 124 per Lord Diplock.

⁴¹ At 132 per Lord Fraser of Tullybelton.

⁴² *Furniss v Dawson* [1984] AC 474.

1 *Furniss: The Facts*

In *Furniss*, the father and son taxpayers sought to sell their shareholdings in two small family companies (the “operating companies”). Prior to the sale, the taxpayers entered into a scheme designed to defer any liability to capital gains tax on the sale of their shareholdings.

On 16 December 1971 an investment company, G Ltd, was incorporated in the Isle of Man. Draft agreements whereby G Ltd agreed to purchase the taxpayers’ shareholdings in the operating companies were approved the same day. The price was to be satisfied by the issue of 151,500 shares of 1p each at a premium of 99p per share. It was agreed that those shareholdings would be sold on to W Ltd for £151,000; the sale and share transfer to W Ltd took place on 20 December 1971. Accordingly, G Ltd acquired the beneficial ownership of the shares in the operating company and had control of them. The taxpayers were assessed to capital gains tax for 1971-1972 on the grounds that their actions represented a disposal of their shares.

On appeal, the Special Commissioners overturned the assessment on the grounds that paragraphs 4(2) and 6(1) of Schedule 7 to the Finance Act 1965 applied to the share exchange. As a result, the shares in G Ltd were for tax purposes to be identified with the shares in the operating companies and treated as the same asset. No liability to tax would arise until the taxpayers disposed of their shares in G Ltd. Although the Crown’s appeal was dismissed by both the lower Court⁴³ and the Court of Appeal,⁴⁴ the House of Lords overturned these decisions, and allowed the Crown’s appeal.⁴⁵

2 *The Decision of the House of Lords*

The House of Lords made apparent that the reach of the *Ramsay* principle was itself not without parameters. Lord Brightman opined that for the principle to apply there must first be a “pre-ordained series of transactions” or “one single composite transaction” which might or might not “include the achievement of a legitimate commercial (i.e. business) end.”⁴⁶ Second, there were to be steps inserted which had no business purpose apart from the avoidance of a liability to tax (but not “no business effect”). If these two elements existed, the inserted steps were “to be disregarded for fiscal purposes.”⁴⁷ His Lordship characterised these matters as

⁴³ *Furniss v Dawson* [1982] STC 267.

⁴⁴ *Furniss v Dawson* [1983] 3 WLR 635.

⁴⁵ *Furniss*, above n 42.

⁴⁶ At 527 per Lord Brightman.

⁴⁷ At 527 per Lord Brightman.

involving two findings of fact or inferences to be drawn from the primary facts by the Commissioners.⁴⁸

Within Lord Scarman's opinion was the suggestion that the process of change had yet to be completed. Remarking on *The Duke of Westminster* Principle, his Lordship wrote that the limits within which that principle was to operate remained "to be probed and determined." However difficult the task might be for judges, it was one which was beyond the power of the "blunt instrument" of legislation. In Lord Scarman's view it would prove to be in the area of "judge-made law" that the elusive "journey's end" would be found.⁴⁹

G What Flows from the Triumvirate?

Following a survey of the "triumvirate" *Ramsay*, *Burmah*, and *Furniss*, it would seem necessary to pause and take stock of the developments these cases represent. Although commentators have approached the matter cautiously, there would seem to have been something approaching a consensus as to nature of the rule itself. R. K. Ashton took *Furniss v Dawson* to have broadly endorsed Lord Diplock's speech in *Burmah*; for the *Ramsay* rule to be applied there were to be present pre-ordained transactions into which there were inserted steps which had no other purpose than the avoidance of tax. Although T. Michael Ashe regarded the uncertainty in relation to the scope of the *Ramsay* rule as "unsatisfactory," he would seem to have regarded *Furniss* as expressing the limitations of the *Ramsay* principle.⁵⁰

Peter Millett⁵¹ viewed the essential components of the House of Lords' approach following *Furniss* as requiring that a single, pre-ordained, composite transaction was to be considered as a whole before it was decided whether it came within a particular statutory provision.⁵² Millett also regarded the issue of motive as irrelevant; the question instead concerned the purpose or effect of the transaction itself. Additionally, he took the view that the first step in the transaction in *Furniss* had only been "disregarded" in the sense that it was not the relevant transaction, "had no commercial purpose, and did not come within the relevant statutory

⁴⁸ At 527 per Lord Brightman.

⁴⁹ At 514 per Lord Scarman.

⁵⁰ Michael Ashe "Ramsay Again" 1987 8(3) *Company Lawyer* 135.

⁵¹ Then Mr Justice Millett of the High Court of Justice.

⁵² Discussing the approaches of the US and UK, Millett identified four principles as integral to both jurisdictions first, the role statutory construction in ascertaining the intent of the legislature, second, that tax avoidance was legitimate, third, that the taxpayer was to be taxed by reference to what he or she had actually done rather than by what he or she might have done to achieve the same object, and finally, that the motive of the taxpayer was irrelevant and should be distinguished from the notion of purpose, which should be understood in terms of the aim, object or end in view. Peter Millett "Artificial Tax Avoidance: the English and American Approach" 6 BTR 1986 327 at 330.

provision” rather than as having been treated as though it had never happened.⁵³ However, Millett regarded Lord Brightman’s words as “expository” and “not to be treated as the words of statute.” The great advantage of judge made law in his view was that it was based on principle and could not be “undermined by microscopic examination in the search for loopholes.”⁵⁴

Alan Berg took *Furniss* as having marked an extension of the *Ramsay* principle from circular transactions which had no purpose apart from tax avoidance to linear transactions which had a legitimate commercial end into which a step had been inserted that had the sole purpose of tax avoidance.⁵⁵ Ashe also noted that where the transactions in *Ramsay* and *Burmah* were self-cancelling, those in *Furniss* were linear. In his view, however, the linear transactions existed “less easily” with the *Ramsay* principle than those which were circular.⁵⁶ Chris Ohms similarly regarded *Furniss* as having widened the scope of *Ramsay*.⁵⁷

John Tiley, however, did not regard *Furniss* as particularly helpful, arguing that the judgment contained “studied vagueness” and left an “intellectual vacuum.” In Tiley’s opinion, the case offered no principle, “unifying or otherwise” and the judges “seemed content to utter the mantra of *Ramsay* as if this solved everything.”⁵⁸

The writer is considerably sympathetic to the perspective advanced by Tiley. Although consistent themes had begun to emerge from those three decisions of the House of Lords, there is the somewhat disquieting sense contained within the judgments of their Lordships that each understood the doctrine which he was expounding a little differently from that of his colleague. Lord Scarman’s comments, in particular, were likely less than reassuring. Yet from these initial struggles, something approaching greater clarity began to emerge from the decisions that followed.

H The Arrival of Craven v White

Following in the wake of the “triumvirate” of *Ramsay*, *Burmah*, and *Furniss*, the case of *Craven v White* (*Craven*)⁵⁹ reached the House of Lords in 1988. While the exact proposition for which it stands remains open to debate, it possibly marked the containment of the doctrine developed in *Ramsay*. However, to what extent this is the case is uncertain in a large part due

⁵³ At 338.

⁵⁴ At 338.

⁵⁵ Alan Berg “Avoidance Schemes after *Craven v White*” (1989) JBL 45.

⁵⁶ At 136.

⁵⁷ Chris Ohms “Fiscal Nullity” (1988-1991) 6 Auckland University Law Review 155 at 162.

⁵⁸ John Tiley “Tax Avoidance Jurisprudence as Normal Law” (2004) 4 BTR 304 at 315.

⁵⁹ *Craven v White* [1989] AC 398.

to the somewhat involved nature of facts, and questions relating to the completion of the transaction itself.

1 Craven: The Facts

In *Craven* the taxpayers both owned shares in, and were the directors of, Q Ltd, a company operating in the grocery trade. In 1976 the taxpayers commenced negotiations with C Ltd for a merger of the two companies, and took steps to establish an Isle of Man holding company as a vehicle for the taxpayers' shares in the event that the merger should eventuate. The taxpayers were subsequently approached regarding the possibility of a sale of Q Ltd to J Ltd. The merger negotiations with C Ltd ceased during negotiations to sell Q Ltd for a price in excess of £2 million. In June 1976, the taxpayers, fearing that the sale to J Ltd would not eventuate, resumed merger talks with C Ltd. M Ltd, an Isle of Man holding company, was incorporated. However, talks were also resumed between the taxpayers, their advisers and J Ltd. On 19 July 1976 the taxpayers exchanged their shares in Q Ltd for shares in M Ltd. On 9 August an agreement was reached whereby J Ltd would purchase the share capital of Q Ltd from M Ltd for £2.2 million subject to adjustments. Payment was to be made by installments: £1.8 million on completion of the sale and the balance by two further payments of adjustable amounts. Between 1977 and 1981 the taxpayers received several substantial interest free loans from M Ltd.

The taxpayers were each assessed pursuant to s 19 of the Finance Act 1965 to capital gains tax for the years 1976-1977 and 1977-1978 on the grounds that they had for tax purposes disposed of their shares in Q Ltd to J Ltd, the share exchange with M Ltd being treated as a fiscal nullity with the result that the disposals had given rise to chargeable gains. The consideration for the disposals was the sums received by M Ltd for the shares of Q Ltd.

The taxpayers appealed to the Special Commissioners, who ruled that while there was a composite transaction for the purposes of the *Ramsay* principle, no part of it was to be regarded as a fiscal nullity. The Crown's appeal against this finding was dismissed by the lower Court,⁶⁰ as it was also by the Court of Appeal.⁶¹ While the House of Lords held that the transactions at issue on appeal all displayed the same basic pattern as the transactions carried out in *Furniss*, it regarded these as having one or more of the salient features present in the transactions in that case missing from those presently at issue.⁶² The result was a victory for the taxpayer.

⁶⁰ *Craven v White* [1985] 1 WLR 1024.

⁶¹ *Craven v White* [1987] 3 WLR 660.

⁶² *Craven*, above n 59, per Lord Oliver at 498.

2 *The Decision of the House of Lords*

In Lord Oliver's opinion, the transactions that the Revenue had sought to reconstruct into a "single direct disposal to an ultimate purchaser" were neither contemporaneous, nor pre-ordained or composite as to allow the ultimate destination of the property to be predicted with any certainty. Indeed, it was unclear whether an ultimate transfer would take place at all. Thus, in his Lordship's view, the facts did not match the criteria set down by Lord Brightman in *Furniss*.⁶³ Although Lord Keith of Kinkel's approach to the *Ramsay* principle left room for Lord Brightman's formulation, his Lordship would appear to have regarded it chiefly as a matter of statutory interpretation. More traditionally Lord Goff of Chieveley opined that some tax avoidance schemes, although not shams, were unacceptable because they involved transactions which were not "real" disposals, or did not generate "real" losses or gains and for this reason, did not to attract the fiscal consequences which would ordinarily attach to disposals, losses or gains under the applicable legislation.⁶⁴

Perhaps most notably, however, all the jurists would seem to have agreed that the question dealt with in *Ramsay*, *Burmah*, and *Furniss* was "essentially one of statutory construction."⁶⁵ This is significant as it in many respects foreshadowed the further development of the *Ramsay* principle in the subsequent case of *IRC v McGuckian*.⁶⁶ Although, in Tiley's view, *Craven* "fell close to the line," it was perhaps as a consequence of this proximity that a somewhat clearer view of where that line lay began to emerge.⁶⁷

I *The Advent of Ensign Tankers*

The case of *Craven* was followed by the 1992 case of *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes) (Ensign)*.⁶⁸ Significantly, this is perhaps the last UK case that might be characterised as following the "traditional" approach emerging from the cases of *Ramsay*, *Burmah*, and *Furniss*.

1 *Ensign Tankers: The Facts*

In *Ensign Tankers*, the taxpayer company and four other British companies entered into partnership with the subsidiary of an American film production company (the production

⁶³ *Craven*, above n 59, at 498 per Lord Oliver.

⁶⁴ At 519 per Lord Goff of Chieveley.

⁶⁵ Berg, above n 55, at 51.

⁶⁶ *McGuckian*, below n 83.

⁶⁷ Tiley, above n 58, at 319.

⁶⁸ *Ensign Tankers Ltd (Leasing) v Stokes (Inspector of Taxes)* [1992] 1 AC 655.

company) to produce and exploit the film “Escape to Victory.” The production company was general partner, while the British companies were limited partners.

The British companies wished to claim first year tax allowances under s 41(1) of the Finance Act 1971 in respect of the entirety of the cost of the film. The partnership entered into agreements with the production company and its subsidiaries under which the partnership contributed \$3.25 million (of which the taxpayers had contributed \$2.3 million) towards the cost of the film. The production company agreed to lend the partnership the cost in excess of \$3.25 million of making the film. The loans were non-recourse, and were only repayable out of 75 percent of the net receipts resulting from the exploitation of the film. The remaining 25 percent of the net receipts was received by the partnership.

The taxpayer appealed against the refusal of the inspector of taxes to allow its claim to first year allowances based on the cost of the film amounting to \$14 million. The taxpayer’s appeal to the Special Commissioners was dismissed on the grounds that the transactions which the partnership had entered into had fiscal motives as a paramount object and were therefore not a trading transaction as such. The lower Court,⁶⁹ however, allowed the taxpayer’s appeal on the basis that the partnership was trading; the Commissioners, in its view, had misdirected themselves. The Court of Appeal⁷⁰ overturned this decision, allowed the Revenue’s appeal, and remitted the case to the Commissioners to decide.

The House of Lords held that the taxpayers were entitled to capital allowances for the 25 percent of the expenditure they had incurred. Although the Crown made no attempt to argue *Ramsay*, Lord Templeman nonetheless helpfully provided a careful summary of much of the case law stretching back to *The Duke of Westminster*.⁷¹

2 *The Decision of the House of Lords*

Lord Templeman held that the particular form of tax avoidance with which the cases of *Ramsay* and *Burmah* were concerned were schemes which sought to obtain for the taxpayer a reduction in taxable income without causing financial loss or expenditure to be incurred.⁷² The distinction between tax mitigation and tax avoidance given by the Privy Council in the New Zealand decision of *Commissioner of Inland Revenue v Challenge Corporation* was

⁶⁹ *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1989] 1 WLR 1222.

⁷⁰ *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1991] 1 WLR 341.

⁷¹ *Ensign*, above n 68.

⁷² At 675 per Lord Templeman.

here important;⁷³ the dictum of Lord Tomlin in *The Duke of Westminster* was only accurate so far as tax mitigation was concerned.

Thus far, Lord Templeman held, tax avoidance schemes had so far been recognisable by “the apparently magical result” to which attention had been drawn by Lord Fraser in *Ramsay* and in *Burmah*, both of which had created “an apparent tax loss which was not a real loss.” In *Furniss* the taxpayer had disposed of shares “without apparently creating a liability to capital gains.”⁷⁴ In the immediate case, Lord Templeman held Victory Partnership had similarly created “an apparent tax expenditure...which was not a real expenditure.” However, his Lordship also held that the principles of *Ramsay* neither compelled nor authorised the courts “to disregard all the fiscal consequences of a single composite transaction” on the grounds that the transaction appeared to be a “tax avoidance scheme,”⁷⁵ thus the *Ramsay* principle was not to be applied to the expenditure of \$3.25 million which was real, and not “magical.”⁷⁶

J The Position following Ensign and Craven

Although both *Ensign* and *Craven* represented developments of the *Ramsay* principle, the essence of the rule would seem to have been retained. In respect of *Craven*, Graham Mansfield argued that, in holding that step-transactions were not “composite” within the meaning of the *Ramsay* principle if the ensuing steps which led to the ultimate disposal were uncertain at the time a tax saving step was inserted, the advent of *Craven* had perhaps served to narrow or contain the ambit of the *Ramsay* rule in the wake of *Furniss*.⁷⁷ Mansfield also noted the emphasis placed by the House of Lords on the role of the construction and application of statutes, and regarded the decision in *Craven* as having “re-characterised the judicial activism in the *Ramsay-Furniss* line of decisions as statutory interpretation.”⁷⁸ Berg also drew attention to their Lordships’ treatment of the question dealt with in *Ramsay*, *Burmah* and *Furniss* as “essentially one of statutory construction.”⁷⁹

⁷³ “Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability...Income tax is avoided...when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction” *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1987] AC 155 at 167, 168 per Lord Templeman.

⁷⁴ At 676 per Lord Templeman.

⁷⁵ *Ensign*, above n 68, at 676 per Lord Templeman.

⁷⁶ Vivien Shrubsall “*Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)*” 4 BTR 1992 279 at 283

⁷⁷ Graham Mansfield “The ‘New Approach’ to Tax Avoidance: First Circular, then Linear, Now Narrower” 1 BTR 1989 5 at 18,19.

⁷⁸ At 5,6.

⁷⁹ Alan G J Berg “Avoidance Schemes after *Craven v White*” Jan Journal of Business Law 45 at 51, 52.

In regards to *Ensign*, Vivien Shurbsall argued that the decision of the House of Lords had added a dimension to the *Ramsay* principle; while the scheme in *Ensign* contained a genuine commercial step and a linear transaction, it also contained “self-cancelling, circular arrangements” with no commercial purpose other than the avoidance of tax. While this did not mean that the revenue could ignore any tax saving step in interrelated transactions, where these represented a single composite scheme, artificial steps could be discounted.⁸⁰ Andrew Halkyard, however, regarded Lord Templeman’s remarks as providing little comfort to taxpayers and their advisors who wondered where the *Ramsay* principle was leading.⁸¹

While both *Craven* and *Ensign* might be said to contain a number of difficulties, all these cases acted to confirm, in the writer’s view, was the prohibition on the creation of “conjured” or “false” losses through the use of complex structures. Importantly, the incremental development of the *Ramsay* line of authority meant that there was arguably present within these cases sufficient information as to enable the astute observer to discern the hallmarks of the arrangements that the courts would likely invalidate. Thus, while matters were still somewhat unclear, they were perhaps not quite as abstract as they might first have appeared.⁸²

K The Arrival of McGuckian

1 McGuckian: The Facts

Whatever the legal position in the UK following *Ensign*, the case of *IRC v McGuckian* (*McGuckian*)⁸³ almost certainly represents a further shift in the approach of the House of Lords to tax avoidance.⁸⁴ The facts of *McGuckian* concerned a taxpayer who transferred shares in B Ltd to a non-resident trustee of a settlement, S Ltd, of which the taxpayer and his wife were the beneficiaries. S Ltd assigned, for consideration, the right to any dividend payable by B Ltd to a UK resident company, M Ltd. B Ltd declared a dividend on the shares held by S Ltd and transferred it to M Ltd. The dividend was then paid on by M Ltd to S Ltd.

The Crown assessed the taxpayer to income tax on the amount of the dividend pursuant to s 478 of the Income and Corporation Taxes Act 1970. The taxpayer appealed to the Special Commissioners who overturned the assessment on the grounds that the transactions were not a sham. By a majority, however, the Court of Appeal⁸⁵ allowed the Crown’s appeal in part,

⁸⁰ Shurbsall, above n 76, at 279.

⁸¹ Halkyard, above n 34, at 20.

⁸² *Ensign*, above n 68, at 681 per Lord Goff of Chieveley.

⁸³ *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991.

⁸⁴ Stephen Hoyle “McGuckian in the House of Lords” (1997) 5 BTR 312.

⁸⁵ *Inland Revenue Commissioners v McGuckian* [1994] STC 888.

holding that the matter might be remitted to the Commissioner with the direction that the assessment should be upheld. On appeal, the House of Lords ruled in favour of the Crown.⁸⁶

2 *The Decision of the House of Lords*

McGuckian presents two distinct approaches to the *Ramsay* rule.⁸⁷ Taking a more traditional view, Lord Browne-Wilkinson regarded the sale and assignment of the right to the dividend at issue as having been carried through by “artificial and pre-ordained steps inserted for no business purpose.”⁸⁸ This, his Lordship said, meant that the liability for tax on the indirect receipt of the dividend by S Ltd had to be determined by “stripping out the artificial steps” and applying the provisions of the Taxes Acts to “the real transaction.” S Ltd, it was found, had received the dividend as income.⁸⁹ Essentially, Lord Browne-Wilkinson examined the transaction at issue, disregarded the steps which were “artificial” and applied the statutory provisions to what remained.⁹⁰

Less traditional was the approach of Lords Steyn and Cooke of Thorndon. Lord Cooke held that while the *Ramsay* principle was not uncommonly seen as a “special to the construction of taxing Acts,” it might “more helpfully” be recognised as an application of the “general approach to statutory interpretation.”⁹¹ While his Lordship noted the limitations contained within formulation offered by Lord Brightman in *Furniss*, he appeared reluctant to regard these as strictly binding. Despite the present case falling within these limitations, his Lordship maintained that if the ultimate question was always the “true bearing” of a taxing provision on a set of facts, the limitations “could not be universals.” Instead, he held, “always one must go back the discernible intent of the taxing Act.”⁹² The “journey’s end,” in his Lordship’s view, had yet to be found.⁹³

These approaches led in two quite different directions. Either the *Ramsay* principle would be retained in the form of the composite transaction doctrine, or it would be transformed into a broader tool of statutory construction. Whatever the merit attaching to the former scenario, it was the latter that prevailed.

⁸⁶ *McGuckian*, above n 83.

⁸⁷ *Tiley*, above n 58 at 321, 322.

⁸⁸ *McGuckian*, above n 83, at 996 per Lord Browne-Wilkinson.

⁸⁹ At 996 per Lord Browne-Wilkinson.

⁹⁰ At 998 per Lord Browne-Wilkinson.

⁹¹ At 1005 per Lord Cooke of Thorndon.

⁹² At 1005 per Lord Cooke of Thorndon.

⁹³ At 1005 per Lord Cooke of Thorndon.

L The case of MacNiven v Westmoreland Investments Ltd

The next case to appear before the House of Lords was *MacNiven v Westmoreland Investments Ltd (Westmoreland)*,⁹⁴ a decision which created considerable confusion.

1 Westmoreland: The Facts

The case concerned a property investment company, W Ltd, which was owned by a tax exempt pension scheme. Following a number of unsuccessful investments, W Ltd became indebted to the pension scheme to an amount over £70 million, of which £40 million was accrued interest. W Ltd had potential value as a company due to its having established tax losses which might be set off against future profits earned by assets transferred to it. The pension scheme lent W Ltd the funds to pay the interest. W limited paid the scheme the interest it owed and also accounted to the Inland Revenue for the tax due on the same day. The effect was to replace W Ltd's liability to the scheme for interest with a liability for an equivalent capital sum. W Ltd was subsequently sold for £2 million.

The Crown refused to allow W Ltd to deduct the interest payments against profits on the grounds that they had not been "payments" within the meaning of s 338 of the Income and Corporation Taxes Act 1988, arguing that these payments had been made purely for the purposes of avoiding tax and ought to be disregarded, or, alternatively, that they were caught by specific avoidance provisions. Although the Special Commissioners at first instance decided that the interest had been paid within the meaning of the applicable section, the lower Court⁹⁵ overturned this decision in favour of the Crown. On appeal, the Court of Appeal⁹⁶ ruled in favour of the taxpayer, a decision upheld by the House of Lords.⁹⁷

2 The Decision of the House of Lords

While Lord Hoffmann acknowledged that the *Ramsay* principle was universally regarded as a principle of construction,⁹⁸ his Lordship held that there was ultimately only one principle of construction, which was to ascertain what Parliament meant by using the language of the statute. All other "principles of construction," his Lordship wrote, could be no more than guides which past judges had put forward to assist in the task of interpretation.⁹⁹ Any formulation of the *Ramsay* rule which looked like an "overriding legal principle, super

⁹⁴ *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311.

⁹⁵ *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [1997] STC 1103.

⁹⁶ *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [1998] STC 1131.

⁹⁷ *Westmoreland Investments*, above n 94.

⁹⁸ At [28] per Lord Hoffmann.

⁹⁹ At [29] per Lord Hoffmann.

imposed upon the whole of revenue law” could not be called a principle of construction as the courts had “no constitutional authority to impose such an overlay upon the tax legislation,” nor, his Lordship argued, had they attempted to do so.¹⁰⁰

Lord Hoffmann sought to explain Lord Wilberforce’s approach to the capital gains in the case of *Ramsay* in terms of a distinction between juristic realities on the one hand and commercial realities on the other. The innovation in *Ramsay*, his Lordship said, was to give the statutory concepts of “disposal” and “loss” a commercial meaning. The new principle of construction was a recognition that the statutory language was intended to refer to commercial concepts.¹⁰¹ This was not, said Lord Hoffmann, a principle of construction, but rather a “statement of the consequences of giving a commercial construction to a fiscal concept.”¹⁰²

Concurring with Lord Hoffmann, Lord Nicholls of Birkenhead emphasised the remarks of Lords Steyn and Cooke of Thorndon in *McGuckian* to the effect that the *Ramsay* principle was an application to taxing Acts of the general approach to statutory interpretation rather than a principle in itself. As to the formulation given by Lord Brightman in *Furniss*, his Lordship held that although the factual situation which it detailed would be one where the *Ramsay* approach would be a valuable aid, it was not “an area for absolutes.”¹⁰³ Rather, the “paramount question” was always the interpretation of the statutory provision and its application to the facts. Prior observations should not be understood as “laying down factual pre-requisites which must exist before the court may apply the purposive *Ramsay* approach to the interpretation of a taxing statute.”¹⁰⁴

M Principles of Construction, Judicial Overlays, and the Ramsay Rule

1 The End of the Ramsay Rule?

While Lord Hoffmann’s judgment served to confirm that the *Ramsay* principle had been subsumed by the purposive approach to statutory construction, it is exceedingly difficult to reconcile this position with the approach contained within the cases of *Ramsay*, *Burmah*, and *Furniss*. Graham Virgo observed that while all the judges had expressed the view that *Ramsay* did not create any “legal principle” as such but rather represented an aid to statutory construction, it was apparent that the decision had been interpreted to mean something more

¹⁰⁰ At [29] per Lord Hoffmann.

¹⁰¹ At [32] per Lord Hoffmann.

¹⁰² At [49] Lord Hoffmann.

¹⁰³ At [8] per Lord Nicholls of Birkenhead.

¹⁰⁴ At [7] per Lord Nicholls of Birkenhead.

than this as “particular tests involving pre-ordained schemes and commercial purposes” had been identified to aid in determining “whether a scheme was effective to avoid tax.”¹⁰⁵

Virgo makes a crucial point. Whatever is to be taken from the case of *Ramsay* itself, it would seem that clear that the application of the principle given by Lords Diplock and Brightman (in the cases of *Burmah* and *Furniss*, respectively) was governed by the presence of factual pre-requisites. From examining these cases alone, one would be forgiven for thinking that it looked very much like a stand-alone legal principle. Following *McGuckian* and *Westmoreland*, however, the *Ramsay* principle was transformed into a broader, purposive approach to statutory construction. It was to this transformation that Lord Hoffmann’s creation of a commercial/legal distinction was integral.

In this respect, Tiley argued that Lord Hoffmann had “extricated himself” from any difficulties posed by the formulations of Lords Diplock and Brightman by stating, in effect, that each set of words “did not amount to a principle of construction as such” but rather served as a “statement of giving a commercial construction to a fiscal concept.”¹⁰⁶ Nabil Orow would seem to have agreed, remarking that where the *Ramsay* rule “began its life as an anti-avoidance principle designed to defeat abusive tax avoidance practices” it had “gradually evolved into a pure statutory interpretation rule.”¹⁰⁷ Seen in this light, Lord Hoffmann’s efforts in *Westmoreland* were almost certainly designed to shift the ground beneath the *Ramsay* rule in such a way as to re-engineer its tenets.

2 A Dubious Distinction?

Whatever the intent behind Lord Hoffmann’s creation of a “commercial/legal” distinction, it was a conceptually problematic dichotomy. Virgo wondered how it was in fact possible to distinguish between the two concepts, dismissing Lord Hoffmann’s suggestion that the proper approach would be to ask whether a commercial person would be able to define the concept or would refer the matter to a lawyer as too uncertain in the context of taxation. How was it that “loss” was to be treated as a commercial concept, but “payment” as a legal concept? How might other key concepts be understood? That Lord Hoffmann accepted that particular concepts may be characterised in different ways depending on their statutory context, said Virgo, only served to complicate matters further.¹⁰⁸ Also critical of the approach taken in

¹⁰⁵ Graham Virgo “The Tax Avoidance Roller Coaster: Another New Approach?” (2001) 60(2) CLJ 259 at 261.

¹⁰⁶ John Tiley “Tax Avoidance as Normal Law” (2004) 4 BTR 304 at 313.

¹⁰⁷ Nabil Orow “Structured Finance and the Operation of a General Anti Avoidance Rule” (2004) 4 BTR 410 at 417.

¹⁰⁸ In Virgo’s view, as the judiciary had not been given any adequate guidance as to how the commercial/legal distinction was to be drawn, this meant that it was no longer a question of whether the UK would have a GAAR, but when. Virgo, above n 105, at 261.

Westmoreland, was Halkyard, who described the map or guide for statutory interpretation left by Lord Hoffmann as “one without a legend.”¹⁰⁹

3 *No Constitutional Authority?*

Other elements of Lord Hoffmann’s approach also came under fire. Edwin Simpson took issue with his Lordship’s findings in respect of the courts’ constitutional authority to impose an overlay on the tax legislation, going so far as to characterise Lord Hoffmann’s pronouncement that the courts were unable to impose such an overlay as a denial that “rings hollow.” Simpson’s argument was that it was inconsistent for his Lordship to make such a claim while simultaneously insisting that the *Ramsay* principle was a principle of construction. Principles of construction, Simpson argued, were by their very nature judicial overlays onto legislation, operating “across the board” in wider circumstances beyond those of a particular statutory word, and accordingly had constitutional significance. Simpson makes an excellent point; if the courts are able to impose a principle of statutory construction upon the law, there would seem no reason why a judicial doctrine such as an earlier embodiment of the *Ramsay* rule could not be imposed upon the law in a similar manner.¹¹⁰ Lord Hoffmann’s remarks would therefore appear somewhat troublesome.

4 *Hoffmann v Templeman?*

The case of *Westmoreland* also served to highlight the differences in the views held by the UK’s brightest legal minds. Writing extra-judicially, Lord Hoffmann spoke of the time which it took for the full implications of *McGuckian* to sink in.¹¹¹ It was only in *Westmoreland*, his Lordship wrote, that the House of Lords was confronted by a clear conflict between a “purposive interpretation of the statute and an extra-statutory application of the *Furniss v Dawson* formula.”¹¹² In choosing the “constructional approach” the House had rewritten history in a way which had “struck some people as a little disingenuous.”¹¹³ However, Lord Hoffmann said, the “sleight of hand” which had obscured “this retreat to constitutional propriety” had not deceived Lord Templeman who had accused the House of Lords “of having deserted the true faith and opened the door to tax avoidance.”¹¹⁴

¹⁰⁹ Halkyard, above n 34, at 26.

¹¹⁰ Simpson gave the example of the ultra vires principle as another judicial overlay relied upon to justify reading into statutes the requirements of natural justice, legality, bad faith, among other things. See Edwin Simpson “The Ramsay Principle: A Curious Incident of Judicial Reticence?” (2004) 4 BTR. 358 at 359, 360.

¹¹¹ Leonard Hoffmann “Tax Avoidance” (2005) 2 BTR 197.

¹¹² At 202.

¹¹³ At 202.

¹¹⁴ Leonard Hoffmann “Tax Avoidance” (2005) 2 BTR 197 at 203.

It is true that Lord Templeman had not received *Westmoreland* favourably. In the *Law Quarterly Review*,¹¹⁵ his Lordship had written that the case had failed to apply the principles and precedents established in the cases of *Ramsay*, *Burmah* and *Furniss*. The future was uncertain due to Lord Hoffmann's attempt to distinguish that which could logically not be distinguished. Although it had sometimes been alleged that the trio of cases which introduced the *Ramsay* approach had introduced uncertainty, from Lord Templeman's perspective, there had never been any difficulty identifying steps which had no business purpose until the *Westmoreland* case had "muddied the waters."¹¹⁶

According to Lord Hoffmann, however, the central lesson that was that "tax avoidance in the sense of transactions successfully structured to avoid a tax which Parliament intended to impose should be a contradiction in terms." Parliament could only express its intention to impose a tax by statute, and the courts should accordingly be trusted "to give effect to its intention." Any other approach, his Lordship wrote, would lead into "dangerous and unpredictable territory."¹¹⁷ While both arguments are compelling, the writer would tend to prefer Lord Templeman's approach for its greater tendency towards consistency and predictability. Whatever its virtues, however, it is Lord Hoffmann's approach to statutory interpretation that has come to characterise the *Ramsay* rule.¹¹⁸

N The Advent of Barclays

Continuing the *Ramsay* line of authority is the more recent House of Lords of *Barclays Mercantile Business Finance Ltd v Mawson (Barclays)*.¹¹⁹

1 Barclays: The Facts

In *Barclays*, Barclays Mercantile Business Finance Limited (BMBF) purchased a pipeline for the transport of natural gas for the sum of £91 million from BGE, an Irish statutory gas supplier. Barclays then leased the pipeline back to BGE, which in turn subleased the pipeline to a United Kingdom based subsidiary of BGE (BGE UK). The purchase price was deposited by BGE with BMBF in return for a guarantee on the part of BGE (UK) to pay the rent. The taxpayer's claim for a writing down allowance under s 24(1) of the Capital Allowances Act 1990 in respect of the purchase price was denied by the revenue.

¹¹⁵ Lord Templeman "Tax and the Taxpayer" (2001) 117(Oct) LQR 575.

¹¹⁶ At 587.

¹¹⁷ Hoffmann, above n 112, at 206.

¹¹⁸ It is also worth noting the apparent disagreement between Lord Hoffmann and Lord Millett over the nature of the *Ramsay* principle. See Geoff Harley "Tax Avoidance: Lord Millett v Lord Hoffman" [2004] NZLJ and "Tax Avoidance: *Arrowtown and Carreras*" [2004] NZLJ 235 by the same author.

¹¹⁹ *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] 1 AC 684.

While both the Special Commissioners¹²⁰ and the High Court of Justice (Chancery Division)¹²¹ dismissed the taxpayer's appeal, the Court of Appeal (Civil Division)¹²² overturned this decision and found in favour of the taxpayer. The Revenue's appeal to the House of Lords was dismissed.¹²³

2 *The Decision of the House of Lords*

The House of Lords held that the statutory requirements in the case of a finance lease were concerned entirely with the acts and purposes of the lessor.¹²⁴ So far as the lessor was concerned, the requirements of the statute had been satisfied. The finding of the Special Commissioner that the transaction had no commercial reality depended on an examination of what happened to the purchaser after Barclays had paid the purchase price to BGE. These were matters which “did not affect the reality of the expenditure by Barclays and its acquisition of the pipeline for the purpose of its finance leasing trade.”¹²⁵ As for the development of the *Ramsay* principle, the case of *Barclays* served to confirm the direction the House of Lords had been taking since the advent of *McGuckian*; the modern approach to statutory construction was to have regard to the purpose of a particular provision.¹²⁶

Their Lordships held that *Ramsay* had “liberated” the construction of revenue statutes from being “literal” and “blinkered.”¹²⁷ The question, said Lord Nicholls, was always whether the relevant provision of the statute applied to the facts as found.¹²⁸ Yet it was evidently felt that this had not been well understood, for his Lordship wrote that the “novelty” for tax lawyers of this exposure to what were described as “ordinary principles of statutory interpretation” meant that *Ramsay* had been regarded as “establishing a new jurisprudence governed by special rules of its own.”¹²⁹

Barclays saw a retreat from the “commercial/legal distinction” put forward by Lord Hoffmann in *Westmoreland*. While their Lordships regarded this as a not unreasonable generalisation, it was, they said, not intended to provide a substitute for a close analysis of

¹²⁰ *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2002] STC (SCD) 78.

¹²¹ *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2002] STC 1068.

¹²² *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2003] STC 66.

¹²³ *Barclays*, above n 119.

¹²⁴ Their Lordships held that the Capital Allowances Act 1990 (UK) said nothing about what the lessee ought to do with the purchase price, how he ought to find the money to pay the rent, or how the plant ought to be used. At [40] per Lord Nicholls of Birkenhead.

¹²⁵ At [41] per Lord Nicholls of Birkenhead.

¹²⁶ *McGuckian*, above n 83, at 999 per Lord Steyn, and *Barclays*, above n 119, at [29], [32] per Lord Nichols of Birkenhead.

¹²⁷ *Barclays*, above n 119 at [29] per Lord Nicholls of Birkenhead.

¹²⁸ At [32] per Lord Nicholls of Birkenhead.

¹²⁹ At [34] per Lord Nicholls of Birkenhead.

what the statute meant, and certainly did not justify the assumption that an answer could be obtained by classifying all concepts a priori as either “commercial” or “legal.” This, their Lordships said, would be the very negation of the purposive construction.¹³⁰

O The case of Scottish Provident

The same day as the release of the decision in *Barclays*, the House of Lords also delivered its decision in the case of *IRC v Scottish Provident (Scottish Provident)*.¹³¹

1 Scottish Provident: The Facts

In June 1995, Citibank International plc (Citibank) proposed to the taxpayer company (a mutual life office scheme named Scottish Provident Institution (SPI)), a scheme designed to create expenses within the proposed new tax regime. The scheme required SPI to grant Citibank an option to buy £100 million short dated gilts at a price discounted from the market price in return for a corresponding premium. Under the law then in place, the receipt of the premium would not be taxable. If, however, the option was exercised after proposed new legislation came into force, the selling of the gilts would be an allowable loss.

On 30 June 1995 an agreement was signed under which Citibank agreed to pay SPI approximately £30 million in return for a call option to buy £100 million of 8 percent UK gilts due 7 December 2000 at 70 percent of their par value. This was exercisable at any time between 30 August 1995 and 1 April 1996. However, to account for the possibility that when the option was exercised the market price might have risen above 100 (and would thus cause SPI a commercial loss), a second option was signed giving SPI the option to buy from Citibank the same amount of the gilts at 90 percent of par value. This was in exchange for a premium of approximately £10 million. In addition, Citibank was to receive a basic set fee and a further fee of 10 percent of the tax saving if the scheme was successful.

The exercise of both options would be self-cancelling and result in a loss which, under new legislation, would be considered an income loss. On 1 April 1996 the proposed law change came into effect such that gilt derivatives were bought within the charging provisions of Part IV of Chapter II of the Finance Act 1994 as a result of the extension of the definition of “qualifying contracts” in s 147(1) to include the addition of a new section 147A(1), a “debt contract or option,” as defined within a new s 150A(1). Upon the exercise of the options, SPI incurred a loss of £20 million which it sought to include in its notice of assessment to corporation tax. SPI appealed against its notice of assessment to corporation tax for the year

¹³⁰ *Barclays*, above n 119, at [38] per Lord Nicholls of Birkenhead.

¹³¹ *Scottish Provident Institution v Inland Revenue Commissioners* [2004] 1 WLR 3172. The judgments of both *Barclays* and *Scottish Provident* were issued 25 November 2004.

31 December 1996 which did not include that amount as a loss. The Special Commissioners¹³² found in favour of the taxpayer, a decision which was upheld by The Inner House of the Court of Session¹³³ on appeal. This was overturned by the House of Lords, which found in favour of the Revenue.¹³⁴

2 *The Decision of the House of Lords*

That SPI would have been entitled to treat the loss which it suffered on the exercise of the Citibank option as an income loss if the option was a “qualifying contract” within the meaning of the applicable legislation, led their Lordships to the short question of whether the Citibank option gave it an entitlement to gilts.¹³⁵ The Special Commissioners had erred in deciding that the fact that there was a commercial risk inherent within the scheme meant that it could not, “without more,” be regarded as a single composite transaction.¹³⁶ In holding that it was, it accordingly created no entitlement to gilts and was not a qualifying contract.

In Lord Nicholls’ view it would “destroy the value of the *Ramsay* principle” if the composite effect of transactions “had to be disregarded” on the grounds that the parties had included a “commercially irrelevant contingency” resulting in “an acceptable risk that the scheme might not work as planned.” This would mean a return to “the world of artificial tax schemes, now equipped with anti-*Ramsay* devices.”¹³⁷ While quite what their Lordships meant by “without more” was not immediately apparent, the court did not entirely discount the proposition that some version of the scheme, albeit in a modified form, might have been allowed. Beyond this, however, their Lordships elected not to elaborate.¹³⁸

P What to make of Barclays and Scottish Provident?

Both *Barclays* and *Scottish Provident* represent the continuation of the purposive approach developed in *McGuckian*. Tiley, however, argued that this produced little certainty as “it is in the nature of questions of construction that there will be borderline cases about which people will have different views.”¹³⁹ He also regarded as “border[ing] on the intellectually unfair,” the remarks of the House in respect of the tendency for tax lawyers to regard *Ramsay* as establishing a “new jurisprudence governed by special rules of its own.” This in Tiley’s

¹³² *Scottish Provident Institution v Inland Revenue Commissioners* [2002] STC (SCD) 252.

¹³³ *Scottish Provident Institution v Inland Revenue Commissioners* [2003] STC 1035.

¹³⁴ *Scottish Provident*, above n 131.

¹³⁵ At [18] per Lord Nicholls of Birkenhead.

¹³⁶ At [24] per Lord Nicholls of Birkenhead.

¹³⁷ At [23] per Lord Nicholls of Birkenhead.

¹³⁸ At [26] per Lord Nicholls of Birkenhead.

¹³⁹ John Tiley “*Barclays and Scottish Provident: Avoidance and Highest Courts; Less Chaos but More Uncertainty*” (2005) 3 BTR 273 at 274.

view sought to “completely remove from history, in best Stalinist style, any responsibility on the part of the judges for some of the intellectual chaos of recent years.” Indeed, the judges themselves had taken the view that the *Ramsay* approach was both new and novel, reminding tax lawyers that it was “too soon to know where the journey would end.”¹⁴⁰ Tiley’s argument is compelling; certainly, it would seem unreasonable for the House of Lords to declaim any contribution to the confusion surrounding a principle which was, after all, a product of their own creation.

It is curious that the House of Lords in *Scottish Provident* used the phrase “without more” to suggest that an alternative version of the scheme might have succeed while simultaneously declining to say anything further. After all, if Lord Nicholls feared to say too much on this point why did he not then leave the matter unaddressed? On what grounds was silence deemed insufficient? Is not the implication that some alternative, more nuanced scheme might have succeeded exactly the “invitation to travel” that his Lordship might have wished to deter? That said, decisions on tax avoidance tend to raise more questions than they profess to answer.

Q Tower MCashback

More recent still is the case of *HMRC v Tower MCashback (Tower MCashback)*.¹⁴¹ This was delivered on 11 May 2011, and represents the most recent UK Supreme Court¹⁴² decision in the line of authority which began with *Ramsay*.

1 Tower MCashback: The Facts

The case of Tower MCashback concerned claims made for first year allowances (FYAs) under s 45 of the Capital Allowances Act 2001 (CAA 2001) in regards to expenditure on software rights.¹⁴³ The respondents, Tower MCashback 1 LLP (LLP1) and Tower MCashback 2 LLP (LLP2), were limited liability partnerships.

¹⁴⁰ At 273.

¹⁴¹ *Commissioners for Her Majesty’s Revenue and Customs v Tower MCashback LLP 1 and another* [2011] UKSC 19.

¹⁴² The final judgments of the House of Lords took place on 30 July 2009, and on 1 October 2009 the Supreme Court United Kingdom opened, and assumed all jurisdiction on points of law for all civil and criminal cases in England, Wales and Northern Island. See “From House of Lords to Supreme Court” (23 July 2009) <www.parliament.uk>.

¹⁴³ *Tower MCashback*, above n 141. Although there was both a procedural and a substantive aspect to the case, it is the latter upon which writer has elected to focus as it would appear to be more pertinent to the subject of discussion. The procedural issue was dealt with at [6] – [24].

On the 31 March 2004, LLP2 entered into a Software Licensing Agreement (SLA) with MCashback which, at heart,¹⁴⁴ represented an obligation on MCashback to grant an exclusive world-wide licence to LLP2 for the use of the software. The consideration was to be £27.5m, which was to be payable on completion against an undertaking on the part of MCashback's solicitors that it be applied to obtain a release of an existing charge on the software and in the procurement of a new security.¹⁴⁵ While the SLA provided that LLP2 was entitled to receive 2.5 percent of the gross revenues from the software, the members of the partnerships paid only £5 million. The remainder was funded by way of two non-recourse loans made by Tower MCashback Finance UK Ltd to the partners of LLP2.¹⁴⁶ Eventually, the case fell to be considered by the UK Supreme Court¹⁴⁷ which ruled in favour of HMRC, the judgment of the Court of Appeal being set aside accordingly with the consequence that only 25 percent of the first year allowances claimed were to be allowed.¹⁴⁸

2 The Decision of the UK Supreme Court

Tower MCashback largely represents the reiteration of the approach set down in *Barclays*. Lord Walker wrote of the “brief summary” given by the House of Lords in *Barclays* and the “more detailed discussion” of the same in *Westmoreland*. These passages, Lord Walker stated, were “well known,” and to these his Lordship stated he only wished to add “a few footnotes.”¹⁴⁹ The case itself turned to a certain extent on the distinction between the decisions of the House of Lords in *Ensign*, and *Barclays*. Where the taxpayers wished to enlist the decision in *Barclays* in aid of their cause and distinguish *Ensign*, HMRC sought to do the opposite (albeit without relying “particularly strongly” on the case of *Ensign*).¹⁵⁰

While in finding for HMRC, his Lordship was aware that commentators would argue that the Court had “abandoned the clarity of [*Barclays*] and returned to the uncertainty of *Ensign*,” his Lordship held that the composite transactions in the present case did not, “on a realistic appraisal of the facts,” meet the test mandated by the CAA 2001. This required “real expenditure for the real purpose of acquiring plant for use in a trade.” Any uncertainty would only arise from the ingenuity of those “determined to test the limits of the capital allowances legislation.”¹⁵¹

¹⁴⁴ At [39] per Lord Walker.

¹⁴⁵ At [39] per Lord Walker.

¹⁴⁶ Jonathan Levy and Adam Craggs “Tower MCashback – where now” (2011) 5 PCB 256.

¹⁴⁷ The somewhat nuanced judicial history of the claims was set out by Lord Walker, in *Tower MCashback*, above n 141, at [3] – [5].

¹⁴⁸ Julian Harris “Courts and tribunals” May/Jun (2011) *Busy Practitioner* 6 at 6.

¹⁴⁹ *Tower MCashback*, above n 141, at [41] – [43] per Lord Walker.

¹⁵⁰ At [26] per Lord Walker.

¹⁵¹ At [80] per Lord Walker.

R HMRC v Mayes

Among the most significant yet of recent UK decisions on tax law is that of *Mayes v Revenue and Customs Commissioners (Mayes)*.¹⁵² As this is an appeal decision, however, it is difficult to know quite what implications it may have for the *Ramsay* line of authority.

1 Mayes: The Facts

Mayes concerned a tax scheme called “SHIPS 2,” which was marketed by a firm of tax advisors. The practical elements of the scheme revolved about the purchase of non-qualifying life assurance policies (AIG bonds) by a non-resident company followed by their partial surrender and a withdrawal of funds. A “corresponding deficiency relief” (or loss) was created by a programme of planned events which was marketed to resident taxpayers of the UK as a means of paying less income tax and claiming capital gains tax loss relief.¹⁵³

While the Special Commissioners¹⁵⁴ ruled in favour of HMRC, matters became more complex at first level of appeal, where Proudman J held in favour of the taxpayer on the deficiency relief issue, but remitted the capital gains tax aspect for further investigation at first instance.¹⁵⁵ At second level, the High Court of Justice (Chancery Division) led by Lord Justice Mummery (Thomas and Toulson LJJ concurring)¹⁵⁶ agreed with the lower Court that the Special Commissioners had both erred in law, and that the capital gains issue should be referred back to the First-tier Tribunal.¹⁵⁷

2 At the High Court of Justice (Chancery Division) at Second Level

In upholding the decision of lower Court, Lord Justice Mummery took the view that the mere fact that two of the steps that had been inserted purely for tax reasons did not serve to invalidate the scheme; there was nothing in the relevant legislation to indicate that the steps were to be overlooked.¹⁵⁸ *Mayes* also reiterated the view that *Ramsay* did not represent a special doctrine of revenue law striking down tax avoidance schemes so much as the general

¹⁵² *The Commissioners for HM Revenue & Customs v David Mayes* [2011] STC 1269 (CA (Civ Div))

¹⁵³ More technically, the Court characterised the scheme as designed to produce both allowable deductions from total income in the form of a corresponding deficiency relief resulting on the disposal of the policies within the meaning of s 549 of the Income and Corporation Taxes Act 1988, and capital sums allowable as deductions in the computation of gains for the purpose of capital gains tax under s 38 of the Taxation of Chargeable Gains 1992. At [12] as per Lord Justice Mummery.

¹⁵⁴ *David Mayes v The Commissioners for Her Majesty's Revenue & Customs* [2009] STC (SCD) 181.

¹⁵⁵ *David Mayes v The Commissioners for Her Majesty's Revenue & Customs* [2009] EWHC 2443 (Ch).

¹⁵⁶ *Mayes*, above n 152.

¹⁵⁷ Harris, above n 148, at 6.

¹⁵⁸ Harris, above n 148, at 6.

principle of purposively construing all legislation.¹⁵⁹ More generally, his Lordship opined that if the taxpayer succeeded and HMRC and Parliament did not like the result, the law could be changed for the future; whether the courts approved of a particular outcome was not the point. It was not for judges “to shoulder the law-making responsibilities of Parliament.”¹⁶⁰

S Tower MCashback, Mayes and whither the UK?

1 Tower MCashback and Mayes

Writing on the implications of *Tower MCashback*, David Goldberg took the view that the taxpayers had essentially argued that they had spent a considerable amount supposedly for software which attracted capital allowances.¹⁶¹ The difficulty, nonetheless, lay in the finding that the software had a market value which was less than the price which had supposedly been paid for it. If £1 million was paid for something which had a market value of tuppence, it was probable that the £1 million was not expended on the thing worth tuppence. This, he wrote, was “not rocket science or neurosurgery, but applied common sense.”¹⁶²

Tower MCashback might be understood in terms of the CAA 2001 requiring that the expenditure for the purpose of acquiring plant or machinery be “real” in order to obtain capital allowances.¹⁶³ However, this is a subtle proposition, for while it was apparently insufficient that in alleging a tax avoidance transaction, HMRC simply point to a circular transaction, it was also not sufficient that, absent a sham, the only possible result was that the entirety of the consideration in the software licence agreements was incurred in the provisions of software.¹⁶⁴ Goldberg also argued that *Ensign Tankers* and *Tower MCashback* displayed an inconsistency; where in *Tower MCashback* there had been no denial that expenditure had been incurred (the issue was instead what it was on), the House of Lords in *Ensign* had regarded there as having been no expenditure at all. This might be resolved, however, if it was accepted that *Ensign* had simply held that there had been no expenditure

¹⁵⁹ *Mayes*, above n 152, at [74] per Lord Justice Mummery.

¹⁶⁰ *Mayes*, above at 152, at [20] per Lord Justice Mummery. His Lordship also drew attention to the remark of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 66 at [35]: “...the ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.”

¹⁶¹ David Goldberg “Tower MCashback LLP 1 v HMR: some reflections” (2011) 5 BTR 522.

¹⁶² At 524.

¹⁶³ *Harris*, above n 148, at 6.

¹⁶⁴ At 6.

on the film, rather than no expenditure at all.¹⁶⁵ This explanation, in the writer's view, is certainly tenable.¹⁶⁶

The decision in *Mayes* might be said to represent a particularly conservative approach on the part of the courts; it is therefore interesting to note that the Supreme Court refused HMRC leave to appeal.¹⁶⁷ However, while the scheme in *Mayes* may have escaped the clutches of the "purposive" *Ramsay* rule, there is the somewhat awkward question of whether it would have escaped the original *Ramsay* principle as it arose from the "triumvirate" quite so readily.¹⁶⁸ Although the writer must confess to being unsure on this matter, if answered in the negative, it would only beg the further question of whether the post-*Barclays* approach has in fact been more generous to taxpayers; in other words, might Lord Templeman have been correct to criticise Lord Hoffmann's new method? Perhaps future decisions will shed light on this matter.

2 Whither the UK?

Although the nature of the *Ramsay* rule's development has obviously presented a challenge to the principle of certainty within the UK's tax law, its cautious pace has arguably acted to mitigate the element of risk inherent in such an innovation. Change, where it did occur, was gradual, and developments which proved to be too problematic were abandoned soon enough; consider, for instance, the retreat of the House of Lords in *Barclays* from the "commercial/legal" distinction given by Lord Hoffmann in *Westmoreland*. The inherent virtue to such an approach is that it has encouraged the UK courts to deal with cases pragmatically; abstractions and legal niceties have taken second place to producing decisions which for the most part have offered taxpayers useful, practical, guidance while simultaneously restraining the worst excesses. So far as the value of certainty is concerned the UK's approach would seem to have its merits.

Whatever the value of the UK's doctrinal approach, however, it is unlikely to remain for much longer. Recent developments, both in government and academia indicate that the UK is on the cusp of enacting a GAAR. Before presenting a short discussion of the proposed GAAR contained in the UK's Finance Bill 2013, a mention of UK's clearance and disclosure regimes would first seem worthwhile.

¹⁶⁵ Goldberg, above n 161, at 525.

¹⁶⁶ The recent case of *Eclipse Film Partners No 35 LLP v HMRC* [2012] UKFTT 270 has posed further questions about the approach taken in *Tower MCashback*. See John Vella "Eclipse Film Partners No 35 LLP v HMRC: a different approach from MCashback?" (2012) 3 BTR 252.

¹⁶⁷ Adam Craggs "SHIPS 2 – Victory for the Taxpayer" (25 November 2011) RPC Tax Take <www.rpc.co.uk>.

¹⁶⁸ Such as, for instance, that given by Lord Brightman in *Furniss*.

T The UK's Clearance Regime

No discussion of tax avoidance in the UK should go without mention of HMRC's clearance regime.¹⁶⁹ As well as providing information through its website, HMRC also operates a clearance regime by which taxpayers may seek clearance or approval for a transaction. Taxpayers may gain non-statutory clearances and advice on advance pricing agreements, company migrations and controlled foreign companies, among other matters. While HMRC provides advice to its customers pre and post-transaction, advisers would, as Mark McLaughlin argued, have cause to utilise the pre-transaction clearance most frequently. HMRC will not, however, accept clearance applications involving tax or national insurance planning arrangements. HMRC requires disclosure, which includes pointing out if a separate disclosure has been made under the disclosure of tax avoidance schemes rules to cover all or part of transactions.¹⁷⁰

This process is, however, subject to a certain measure of discretion. For instance, even where a clearance request might fall within the strict legislative criteria, it may nonetheless be regarded as inconsistent with the underlying policy of the legislation. Where such an inconsistency results in a tax advantage, HMRC may refuse to respond. There is no right of appeal except in limited circumstances. This was a concern to McLaughlin as it involved a judgment call on HMRC's part.¹⁷¹ While some might argue that the presence of a clearance regime represents a failure in the operation of the UK's judicial doctrine, this is not necessarily the case. Rather, the existence of a clearance regime is could just as easily be characterised as a consequence of the Revenue's prosecutorial discretion and limited resources, as well as any uncertainty arising from the approach taken by the UK courts to statutory construction.

U Disclosure and HMRC

Also to present difficulties is HMRC's disclosure regime. In November 2012 it was reported that the UK National Audit Office (NAO) had found that HMRC was dealing with a backlog of 41,000 cases involving up to £10.2 billion. Although it was reported the Disclosure of Tax Avoidance Schemes (DOTAS) facility had helped the Revenue "change tax law" and "prevent some avoidance activity," challenging a scheme was nonetheless described as a

¹⁶⁹ HMRC runs an "Anti-Avoidance Group," responsible for the "development, maintenance and delivery of the Department's Anti-Avoidance Strategy." HM Revenue and Customs "About the Anti-Avoidance Group" <www.hmrc.gov.uk/avoidance/about-aag.htm>.

¹⁷⁰ Mark McLaughlin "Making it Clear" (2010) Jul/Aug Busy P 1 at 1.

¹⁷¹ At 2.

“resource intensive process” which could take years, often requiring litigation.¹⁷² Further, while 100 avoidance schemes had been disclosed under DOTAS, the report found no evidence to suggest their rate of incidence had been reduced.

HMRC claimed it had successfully challenged 40 schemes in the last two years and argued that stronger powers to obtain information, coupled with the introduction of a GAAR in 2013, would assist its work.¹⁷³ The NAO, however, expressed concern that HMRC did not monitor its costs or identify how it would evaluate its effectiveness. These matters aside, it is now time to consider the UK’s impending adoption of a GAAR.

V The Argument for a UK GAAR

The movement toward a GAAR in the UK has been steadily gaining traction for some time. In 1997 the Tax Law Review Committee stated its preference for a “sensibly targeted general anti-avoidance provision” with a “considered framework and appropriate safeguards for taxpayers.” The idea was, however, rejected following a proposal from the HMRC that was considered not to contain the checks and balances necessary to safeguard the taxpayer.¹⁷⁴

Among the most articulate advocates of a GAAR for the UK is Judith Freedman,¹⁷⁵ who, in 2004, argued in favour of a general anti-avoidance rule for the United Kingdom as part of an effort to offer taxpayers direction as to where the “boundaries of behaviour” lay.¹⁷⁶ Importantly, however, Freedman did not argue that this would achieve certainty, but that the value of certainty was the wrong test of her argument.¹⁷⁷ While Freedman conceded that certainty had “great significance” in commercial and criminal law, there were, she argued, circumstances in which it should not be the overriding aim, and might prove to be elusive or undesirable.¹⁷⁸ Freedman’s view was that a GAAR would provide the overlay required to give legitimacy to judicial development and offer a framework in which the uncertainty inherent in any system capable of tackling tax avoidance could be fairly managed. Freedman spoke of the need to, in some cases, “shift the focus from trying to create clear lines” (which, she argued, might be an impossibility), instead towards, how “we enable decisions to be

¹⁷² Robert Lovell “NAO exposes HMRC tax avoidance failure” (21 November 2012) Accounting Web <www.accountingweb.co.uk>.

¹⁷³ Lovell, above n 172.

¹⁷⁴ Tax Law Review Committee 1997 at vii. See Judith Freedman “GAAR as a Process and the Process of Discussing the GAAR” (2012) 1 BTR 22 at 22.

¹⁷⁵ See also Judith Freedman “Interpreting Statutes: Tax Avoidance and the Intention of Parliament” (2007) Jan LQR 53.

¹⁷⁶ Judith Freedman “Defining Taxpayer Responsibility” (2004) 4 BTR 332 at 333.

¹⁷⁷ At 333, 354.

¹⁷⁸ At 333.

made in individual cases fairly and within a legitimate and non-arbitrary framework.”¹⁷⁹ There would be no detriment caused to the rule of law if the area of uncertainty was not such as to affect “day-to-day transactions” and was governed “not by arbitrariness but rather by procedures that attract the support of the compliant members of the tax community.”¹⁸⁰

Yet with respect to Professor Freedman, the difficulty with such a proposal lies in the inherent ambiguity contained within it. Take, for example, the use of the term “day-to-day” to describe the sorts of transactions that would be left unhindered by a GAAR. How might these be described? How might their tenets be determined? What makes a member of the tax community “compliant?” How is the realisation of goals founded on such abstractions to be measured? The answer, it is submitted, must be with recourse to subjective value judgments. Such an approach cannot help but be arbitrary; indeed, it would seem in its nature to be so. Yet tax law, integral to the flourishing of commerce and industry, must be capable of offering taxpayers practical, constructive guidance in respect of how they may order their affairs. It is this which Freedman’s approach puts at risk.

W Practical Steps Towards a GAAR

These concerns notwithstanding, the United Kingdom’s movement toward a GAAR has accelerated. In December 2010, the Government commissioned Graham Aaronson QC to undertake a study that would consider whether a general anti-avoidance rule could “deter and counter tax avoidance whilst providing certainty, retaining a tax regime that is attractive to businesses, and minimising costs for businesses and HMRC.”¹⁸¹ The report, published on 21 November 2011,¹⁸² found that the introduction of a broad spectrum rule would not be beneficial on the grounds that it would carry a real risk of undermining the ability of individuals to carry out “sensible and responsible” tax planning.¹⁸³ The report also said that a broad spectrum rule would require a comprehensive system for obtaining advance clearance which would impose “substantial resource burdens” on taxpayers and HMRC alike. This would also in practice give discretionary power to HMRC, which would “effectively become the arbiter of the limits of responsible tax planning.”¹⁸⁴

The report did find, however, that the introduction of a GAAR targeted at “artificial and abusive tax avoidance schemes”¹⁸⁵ would be beneficial¹⁸⁶ on the grounds that it could,

¹⁷⁹ At 354.

¹⁸⁰ At 356, 357.

¹⁸¹ HM Revenue and Customs “A General Anti-Abuse Rule Consultation Document” (12 June 2012) at [1.1].

¹⁸² HM Treasury “General Anti-Abuse Rule” <www.hm-treasury.gov.uk>.

¹⁸³ Graham Aaronson QC “GAAR Study: A Study to Consider Whether a General Anti-Avoidance Rule Should be Introduced into the UK Tax System” at [1.5].

¹⁸⁴ At [1.6].

¹⁸⁵ At [5.42].

amongst other things, deter (and where deterrence failed, counteract) “contrived and artificial schemes,”¹⁸⁷ produce a more level playing field for businesses,¹⁸⁸ reduce the risk of “stretched interpretation”¹⁸⁹ and make it possible (by eliminating the need for a “battery” of specific anti-avoidance sub-rules) to draft future rules more simply and clearly.¹⁹⁰ As HMRC’s website declares, the overall conclusion was that the introduction of such a rule would “improve the UK’s ability to tackle tax avoidance.”¹⁹¹ The Government, it was said, would “consult with a view to bringing forward legislation in Finance Bill 2013.”¹⁹²

Following the publication of the Aaronson Report, it was reported by BBC Business News in March 2012 that Chancellor George Osborne had announced Treasury’s plans to introduce a GAAR.¹⁹³ Yet according to Reuters, while the reception to the news had been initially positive (UK companies perhaps regarding the GAAR as a means of tackling negative perceptions of business), enthusiasm for the measure dampened somewhat after it was suggested that the rule might be stricter than had been first indicated.¹⁹⁴

The Aaronson Report had envisaged a narrowly focused instrument intended to capture only highly artificial offshore schemes, leaving the channeling of profits from genuine sales untouched.¹⁹⁵ Following the publication of the UK Government’s draft legislation in June 2012, however, it became apparent that what the UK Government envisaged was perhaps somewhat broader GAAR than that which the Aaronson Report had suggested.¹⁹⁶ On 11 December 2012 HMRC published its Summary of Responses, which contained the various views that it had received on the merits of a GAAR. This document also stated that the UK Government had proposed that the GAAR should take effect from the day on which Finance Act 2013 was passed.¹⁹⁷ On 25 January 2013, HMRC announced the membership of the

¹⁸⁶ Readers may also be interested to read Helen Lethaby’s remarks on the GAAR advocated by Aaronson in a recent article for the British Tax Review. Lethaby drew attention to the manner in which *Mayes* was “much maligned in the report,” suggesting that it and other cases like it may have provided significant impetus for the enactment of a statutory instrument. Helen Lethaby “Aaronson’s GAAR” (2012) 1 BTR 27 at 32.

¹⁸⁷ At [1.7(i)].

¹⁸⁸ At [1.7(ii)].

¹⁸⁹ At [1.7(iii)].

¹⁹⁰ At [1.7(iv)].

¹⁹¹ HM Treasury, above n 182.

¹⁹² HM Treasury, above n 182.

¹⁹³ Fiona Fernie “George Osborne’s new plans to tackle tax avoidance” (27 March 2012) BBC Business News <www.bbc.co.uk>.

¹⁹⁴ Tom Bergin “Business spooked by UK tax avoidance clampdown” (4 October 2012) Reuters <www.reuters.com>.

¹⁹⁵ Bergin, above n 194.

¹⁹⁶ See for instance Grant Thornton “A General Anti-Abuse Rule: Comments on the Consultation Document Released on 12 June 2012” (2012) Grant Thornton <www.grant-thornton.co.uk>.

¹⁹⁷ HMRC “A General Anti Abuse Rule: Summary of Responses” (11 December 2012) at [9.2].

interim members of the Advisory Panel (chaired by Aaronson) who were to review the GAAR guidance to be published with the 2013 Finance Bill. That the GAAR will closely reflect the Government's draft would seem all but assured.

X The UK's Draft GAAR

1 Draft GAAR Contained in Part Five of UK Finance Bill 2013

The key provisions of the draft GAAR are set out in Finance Bill 2013. As will soon become apparent, many of the elements and concepts contained within the proposed UK GAAR bear similarities to those employed in other jurisdictions. Although not intended to be comprehensive, and without including the lengthy sections of the Bill itself (for these see Appendix), there are a few points worth making. In this respect, readers may wish to first refer to the discussion of the respective GAARs of New Zealand (s BG 1) and Canada (s 245) in Chapters Six and Seven.

2 General Remarks

(a) Ambiguous Terms and Concepts

The feature most common to statutory GAAR is the introduction of, and reliance upon, terms and concepts which are ambiguous and ill defined. Clause 205, for instance, refers to the concept of the "tax advantage." This mirrors the reference in New Zealand's GAAR, s BG 1, to "tax avoidance," and that of Canada's s 245 to the "tax benefit." In each case, however, the difficulty is that there is no indication as to how the higher tax position is to be calculated, meaning that the amount "avoided" is likely to be based on a subjective inference in respect of how the taxpayer might have acted in the alternative.

The reference contained in clause 204 to the "tax arrangement" would seem similar to s BG1's "tax avoidance arrangement," or s 245's "avoidance transaction." Where clause 204 differs from s BG 1 and aligns itself more closely to s 245, however, is in its reference to the "main purpose" or "one of the main purposes" of the arrangement, suggesting that it does not confuse purpose or effect in the same way as s BG 1. It may also represent something of an improvement upon s 245 in not referring to the notion of "bona fide purposes" in the abstract. However, given its reference to the "purpose of the arrangement," it would seem not unreasonable to assume that recourse may be had to the concept of "objective purpose" in much the same way as New Zealand and Canada. It would also not be surprising if the onus of contesting both the presence of a "tax advantage" and a "tax arrangement" was to be placed upon the taxpayer.

(b) Infallibility?

Where the GAAR proposed by the Aaronson Report envisaged a specific exclusion for any arrangement by which the party who benefitted from the tax advantage could prove that the arrangement was entered into for non-tax reasons, the authors of the draft GAAR regarded this as unnecessary on the grounds that arrangements entered into without tax intent would “automatically be excluded from the GAAR.”¹⁹⁸ The difficulty with this reasoning, however, is that it essentially assumes that the only transactions to which the Revenue will allege the UK GAAR applies will, in fact, be those to which it applies, or that, in other words, the courts and Revenue will not commit errors of classification. This is obviously problematic.

(c) Abuse and the “Double Reasonableness” Test

The reference contained within clause 204 to the concept of abuse is almost certainly due to the influence of Canada’s s 245. Clause 204 states that “abusive” arrangements are those which cannot “reasonably be regarded as a reasonable course of action.” This is referred to as the “double reasonableness” test. While this may originally have been designed to ensure that the barriers to the GAAR’s application remained high, it is questionable as to whether this is likely to be effective.¹⁹⁹ Judges (in addition to the officers of HMRC) will, after all, differ among themselves as to what is “reasonable” in each context, raising the risk of increasingly subjective decision making. Guidance published by HMRC has indicated that the onus of establishing that an arrangement is abusive will rest with the Revenue.²⁰⁰

Clause 204(2) lists circumstances to which regard may be had, including the presence of “contrivance” or “abnormality,” and the “substantive results of the arrangements” in addition to “whether the arrangements are intended to exploit any shortcomings” in the provisions. As this list of considerations would seem to be broad and wide ranging, there is the risk that it will afford HMRC too wide a measure of discretion in selecting the grounds upon which it would seek to strike down arrangements which it considers to be “offending.”

(d) Counteraction, Adjustment and Other Provisions

Clause 206(2) requires that the adjustments made to counteract tax advantages should be “just and reasonable.” However, what this means is unclear. How, for instance, might a transaction which has been counteracted on an “unjust and unreasonable” basis be

¹⁹⁸ HM Revenue and Customs, above n 181, at [3.11].

¹⁹⁹ Frixos Hatjantonas “The draft GAAR: the ‘double reasonableness test’” (29 August 2012) Tax Journal <www.taxjournal.com>.

²⁰⁰ HM Revenue and Customs “HMRC’s GAAR Guidance” (15 April 2013) at B12.1.

recognised?²⁰¹ The nature of the standard by which the determination is to be made is elusive. Also potentially problematic is clause 209, which sets out the relationship of the GAAR to other priority rules. While this states that priority rules are to be read subject to the GAAR, there is the unresolved question of what constitutes a priority rule; while some examples have been provided, disputes on this point would seem all but inevitable.

Y HMRC's Advice

HMRC makes a reasonable amount of information concerning its approach to tax avoidance available through its website. This contains a “spotlights” section in which HMRC may point out schemes which it believes are being used to avoid tax, and provides some guidance as to the signposts which may indicate avoidance. More broadly, HMRC’s website emphasises the DOTAS rules, and the role of the upcoming GAAR. In this respect, HMRC has helpfully provided advice and guidance on the prospective application of the GAAR. This includes a summary of the GAAR’s intended aims, and an explanation of procedure, as well as a number of examples designed to assist taxpayers in knowing whether an arrangement might be regarded as abusive.²⁰² However, the extent to which this guidance is likely to assist taxpayers or influence the approach of the courts and HMRC is debatable.²⁰³ Taxpayers would therefore be well advised to tread cautiously.

Z Findings

The doctrine arising from *The Duke of Westminster* in 1935 once mandated that tax statutes be interpreted narrowly, according to legal form, without regard for substance. The consensus that prevailed for approximately half a century was shattered by the arrival of *Ramsay* in 1981, which introduced taxpayers to the “step transaction doctrine” or *Ramsay* principle, whereby steps which had no commercial purpose could be discarded and the result taxed accordingly. This principle was affirmed by the decisions of *Burmah*, also in 1981, and *Furniss* in 1984, with the result that the application of the doctrine was extended beyond circular transactions to linear transactions with similar characteristics.

At least initially, the principle which developed from the “triumvirate” of *Ramsay*, *Burmah*, and *Furniss*, with its references to a “pre-ordained series of transactions” containing steps which had “no business purpose,” looked very much like a stand-alone judicial doctrine imposed upon revenue law. Then, as now, the onus of contesting the revenue’s assessment

²⁰¹ Parallels might here be drawn with the reference contained within Canada’s s 245 to “reasonable tax consequences.” See Chapter Seven.

²⁰² This is provided at HMRC’s website. See HMRC “The General Anti-Abuse Rule” <www.hmrc.gov.uk>.

²⁰³ In Canadian case of *Copthorne Holdings Ltd v R*. 2011 SCC 63 the Supreme Court of Canada decided that the term “contemplation” could be construed both prospectively and retrospectively, notwithstanding the opinion of a then Director of Revenue Canada to the contrary.

lay with the taxpayer,²⁰⁴ and the concept of purpose was understood not in the sense of “motive” but rather “objectively” in terms of the “end in view.” Where the advent of *Craven* in 1988 served to demonstrate the principle’s parameters, and also to foreshadow the role of statutory construction, the decision in *Ensign* in 1992 emphasised the need for expenditure to be “real” rather than “magical.” Again, however, the incremental development of the *Ramsay* line of authority and the specific pronouncements of the jurists arguably meant that there was within these cases sufficient information as to enable the astute observer to discern where the line lay.

Both *McGuckian* in 1997 and *Westmoreland* in 2001 represented the disestablishment of accepted authority; if the *Ramsay* rule had once represented a distinct judicial doctrine, then following the arrival of these cases, this was the case no longer. Both cases are problematic; the different approaches taken by the jurists in *McGuckian* and the creation of a “commercial/legal” distinction in *Westmoreland* doubtless caused considerable confusion for academics and taxpayers alike. However, while it is not intended that the difficulties created by be overlooked in order that GAAR jurisprudence should appear more chaotic by comparison, it is important that these be seen in their broader context. It is a virtue of the common law that retreat may be had from elements which, for one reason or another, prove too problematic. In this respect, it is noteworthy that the “commercial/legal” distinction given by Lord Hoffmann was abandoned in *Barclays*, perhaps because it was simply too difficult to administer.

It was not until the decisions given in *Scottish Provident* and *Barclays* in 2004 that the UK’s tax avoidance case law appeared to settle once more. In this respect the 2011 decision in *Tower MCashback* presents few surprises. The 2011 case of *Mayes* is perhaps something of an anomaly, and the writer is somewhat surprised that HMRC’s appeal was refused. However, as this is a lower court decision, it is in the writer’s view unlikely to signal a shift in the judicial approach to tax avoidance in the UK.

It should also be said that *Ramsay* principle (or approach, howsoever it is to be called) does not permit the re-characterisation of transactions. Rather, it seeks “to give effect to what the parties really intended by the legal transactions, not to substitute transactions with a different legal character.”²⁰⁵ As this represents merely the annihilation of tax avoidance elements, it is easier to reconcile with the purposive approach to statutory construction; those elements which exist outside the ambit of the legislation are simply held to be dysfunctional, or otherwise inoperative. Problems of “functionality” do not arise in the same way as they do under a GAAR.

²⁰⁴ See s 50(6) of the Taxes Management Act 1970.

²⁰⁵ Malcolm Gammie “Sham and Reality: The Taxation of Composite Transactions” (2006) 3 BTR 294 at 303, 304.

AA Conclusion

In all, the UK would seem to have managed its approach to tax avoidance reasonably well. With the possible exception of *Westmoreland*, the approach of UK courts has for the most part been predictable and principled, at least so far as its most prominent decisions are concerned. Developments in its law have generally taken the form of the incremental changes which characterise the evolution of the common law. As a consequence, the UK's approach arguably carries with it fewer implications for the value of certainty than those of Canada and New Zealand.

What the adoption of a GAAR will mean for its jurisprudence is unclear; however, one important question is how far its jurists will be allowed to go in striking down tax avoidance arrangements. Although the UK's judges are doubtless aware of the public's disdain for the excesses of the UK financial industry's excesses, they have generally been observed to tread a path of cautious, rather than radical, reform. While the UK's future is uncertain, it is probable that (assuming a GAAR is adopted) it will be applied warily, at least initially. The UK is, after all, by no means unaware of the value of its financial services industry, or anxious to see the City of London lose business to its competition in Zurich and New York. Pragmatism, in other words, may yet dictate the pace.

V CANADA

A Introduction

1 Canada's Great Significance

Canada's experience with general anti-avoidance rules is highly significant to any discussion of the disparate approaches to dealing with income tax avoidance within the British Commonwealth. For reasons which will shortly become apparent, Canada's GAAR is in many respects the most aggressive of its kind (indeed, its influence on the UK's Draft GAAR can arguably be discerned). The complex and challenging nature of the cases which appear before Canada's judiciary also serve to illustrate many of the conceptual problems that accompany the use of general legislation. The consideration of the Canadian position is therefore of considerable importance to a discussion of the implications of measures designed to deal with tax avoidance in the British Commonwealth.

2 Order of Procession

Delving into Canada's tax jurisprudence, this Chapter commences with a discussion of the case of *Stuart*,¹ which is important as it in many respects precipitated the passage of the current Canadian GAAR.² A discussion of the mechanics of Canada's GAAR follows,³ after which attention is then given to the GAAR's maiden voyage in the case of *McNichol*.⁴ Following this, the Chapter turns to an examination of the cases of *Canada Trustco*⁵ and *Mathew v The Queen*,⁶ in which the present approach of Canada's judiciary was established. After this attention is turned to two of Canada's recent significant decisions, *Lipson*⁷ and *Copthorne*.⁸ Findings and a brief conclusion follow.

Throughout this Chapter, there is an emphasis on the recurring themes and conceptual difficulties arising from the use of Canada's GAAR, and their implications for the value of certainty. Importantly, many of these would seem to bear close relation to the underlying problems identified with the use of GAARs in Chapter Three.

¹ *Stuart Investments Ltd v R* [1984] 10 DLR (4th) 1.

² Canada's present GAAR is contained within s 245 of the of the Canadian Income Tax Act Income Tax Act, RSC 1985, c 1 (5th Supp).

³ Joel Nitikman "Is GAAR Void for Vagueness" (1989) 37(6) Can Tax J Rev Fiscale Can 1409.

⁴ *McNichol v The Queen* [1997] 2 CTC 2088.

⁵ *Canada Trustco Mortgage Co v R* 2005 SCC 54.

⁶ *Mathew v R* 2005 SCC 55.

⁷ *Lipson v R* 2009 SCC 1.

⁸ *Copthorne Holdings Ltd v R*. 2011 SCC 63.

B The Case of Stubar v The Queen

The case of *Stubar v The Queen (Stubar)*⁹ arguably marks the beginning of the “modern” era of income tax avoidance. It also very likely provided Canada’s legislature with the impetus for the enactment of the present Canadian GAAR s 245 of the Canadian Income Tax Act 1985.¹⁰

1 Stubar: The Facts

In *Stubar*, a sister subsidiary of the appellant taxpayer company had incurred losses for the purposes of the carry forward provisions of the Canadian Income Tax Act 1952 (ITA 1952).¹¹ The appellant taxpayer sold its assets to its subsidiary, concurrent with which the subsidiary appointed the appellant as its agent to carry on business on its behalf, which the appellant duly did. The appellant paid the net income realised from the business to its sister subsidiary. The sister subsidiary reported the income in its tax returns for three years. However, the Department of National Revenue reassessed the appellant, and charged the net income transferred to the subsidiary back to the taxable income of the appellant on the grounds that the transaction was incomplete, a sham and devoid of a business purpose.¹²

At the time, Canada had as its anti-avoidance provision s 137 of the ITA 1952. However, this section was not relied upon by the Crown, presumably (as Estey J in *Stubar* remarked), in the hope that the tax liability of the appellant would be founded on the “genuine business purpose” principle or “abuse of rights” doctrine.¹³ Although the revenue’s assessment was upheld by the Tax Appeal Board,¹⁴ the Federal Court (Trial Division)¹⁵ and the Federal Court of Appeal,¹⁶ the decision of Supreme Court went in favour of the taxpayer.

2 The Decision of the Supreme Court

Wilson J held that an arrangement might have no business purpose other than the tax purpose; were the Minister to be permitted to ignore a transaction on that ground alone this would represent a “massive inroad” into the dictum given by Lord Tomlin in *The Duke of Westminster*. In Wilson J’s view, Lord Tomlin’s dictum was “far too deeply entrenched” in

⁹ *Stubar Investments Ltd v R* [1984] 10 DLR (4th) 1.

¹⁰ Income Tax Act, RSC 1985, c 1 (5th Supp).

¹¹ Income Tax Act, RSC 1952.

¹² See David Debenham “The Winds of Taxation” (1986-1987) 51 Sask L Rev 292.

¹³ *Stubar*, above n 9, at [15] per Estey J.

¹⁴ *Stubar Investments Ltd v R*. [1974] CTC 2284.

¹⁵ *Stubar Investments Ltd v. R.* [1978] CTC 612.

¹⁶ *Stubar Investments Ltd v. R.* [1981] CTC 1.

Canadian law for the courts to reject it in the absence of “clear statutory authority.” This, his Honour regarded as lacking.¹⁷

Estey J similarly opposed the introduction of the “comprehensive” business purpose test. In his Honour’s view, a strict business purpose test would in certain circumstances run counter to intent of the legislature. In imposing a positive requirement that a bona fide business purpose be present within a transaction, a taxpayer might be barred from undertaking the very activity Parliament wised to encourage.¹⁸ Instead, his Honour held that it would be more appropriate to “turn to an interpretation test” which offered a means of “applying the act so as to affect only the conduct of a taxpayer which had the designed effect of defeating the expressed intention of Parliament.”

3 *The Consequences of Stubart*

The consequences of *Stubart* were threefold. First, it affirmed that taxpayers were free to minimise their liability to tax if doing so meant taking advantage of incentives or inducements contained within the Act through which the legislature had sought to accomplish various policy goals and objectives. Second, *Stubart* acted to usher in a more “purposive” style of interpretation under which the intent of the enacting legislature came to the forefront of the judicial process. Third, and perhaps most important of all, as a result of the Supreme Court’s rejection of the comprehensive business purpose test, Canada adopted its present GAAR, s 245.

C *The Rationale for the Enactment of Section 245*

Upon its passage in 1988, the purpose of s 245 was explained in the *Explanatory Notes to Legislation Relating to Income Tax* issued by the then Minister of Finance, the Honourable Michael H. Wilson. These, while “intended for information purposes only” and not as an “official interpretation” of the provisions, described the underlying rationale of the GAAR as “intended to prevent abusive tax avoidance transactions or arrangements” but “not intended to interfere with legitimate commercial and family transactions.” The rule sought to “distinguish between legitimate tax planning and abusive tax avoidance” and “establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs.”¹⁹

¹⁷ At [72] per Wilson J.

¹⁸ At [55] per Estey J.

¹⁹ *Canada Trustco*, below n 38, at [15].

D The Components of s 245

(a) Charging Provision

The operative or “charging” provision is s 245(2). It provides as follows:

Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

(b) Avoidance Transaction

Section 245(3) gives the following definition of an “avoidance transaction”:

(a) An avoidance transaction means any transaction (a) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; or

(b) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

While the *Explanatory Note* explained that a transaction that was undertaken primarily for bona fide business, investment or family purposes would not be an “avoidance transaction” it also said that there were nonetheless many transactions that had a business investment or family effect which might be avoidance transactions if their primary purpose was obtain a tax benefit.²⁰

(c) A Series of Transactions

Section 248(10) provides the definition of a “series of transactions”:

For the purposes of this Act, where there is a reference to a series of transactions or events, the series shall be deemed to include any related transactions or events completed in contemplation of the series.

²⁰ Revenue Canada “Information Circular 88-2: General Anti-Avoidance Rule Section 245 of the Income Tax Act” (October 21 1988) <www.cra-arc.gc.ca> at [4].

(d) The Tax Benefit

Section 245(1) provides the following definition of “tax benefit”:

Tax benefit means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act.

(e) Misuse or Abuse: s 245(4)

Subsection 245(4) subjects s 245(2) to the following constraints:

For greater certainty, subsection 245(2) does not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole.

Following its amendment in 2004 by the *Budget Implementation Act, No 2* (BIA) s 245(4) now reads:

Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

- (a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
 - i. this Act,
 - ii. the Income Tax Regulations,
 - iii. the Income Tax Application Rules,
 - iv. a tax treaty, or
 - v. any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or
- (b) would result directly or indirectly in an abuse having regard to those provisions other than this section, read as a whole.

The amended s 245(4) is noticeably broader than its predecessor in that it contains a wider range of Acts and instruments capable of being the subject of “misuse.” As to the concepts of “misuse” and “abuse” themselves, however, the *Explanatory Note* to s 245(4) offered few insights save that transactions must have “real economic substance,” and that the attainment of tax benefits must come within the “object and spirit of the provisions of the Act read as a whole.” Section 245 would apply where a taxpayer carried out transactions primarily in order to gain a tax benefit not intended by the Act, even where the strict words of those specific provisions might “support the tax result sought by the taxpayer.”²¹

²¹ *Canada Trustco*, below n 38, at [48].

E Conceptual Difficulties within s 245

Foremost among the difficulties with s 245 are the broad and vague definitions contained within it. Indeed, these border on the indecipherable. It is the ambiguity contained within s 245 that the writer would now seek to consider.

(a) What is an “Avoidance Transaction?”

The definition of “avoidance transaction” is given by s 245(3) as (to paraphrase) “any transaction that would result in a tax benefit unless undertaken for bona fide purposes.” The first problem with s 245(3) is that while the authority of s 245 is made subject to “bona fide purposes” it is nowhere explained what these are. It is therefore almost impossible to see how this caveat can be considered to be of any use at all as it adds nothing to that which is contained within the definition already. Although this would, of course, suggest that the courts ought to provide guidance as to what constitutes bona fide purposes, it is clear that this must be a development of their own, given the absence of guidance contained within the provision itself. This leaves us with the definition of an “avoidance transaction” as “any transaction that would result in a tax benefit.” However, as explained in Chapter Three, it is already implicit in the concept of “tax avoidance” that the transaction at issue represents a lower tax position than the one which the Revenue would prefer the taxpayer to have taken. Section 245(3) would therefore seem to represent little more than a tautology.

(b) “Reasonable” Tax Consequences

Difficulties arise from the use of the word “reasonable” in s 245(2). While this term has had a long and established history of usage in the field of negligence and in other sections of Canada’s ITA and might be said to be uncertain as a matter of fact rather than vague as a matter of law,²² its meaning in this context is highly problematic. The reason this is so is that the use of the term “reasonable” in other areas of Canada’s Income Act refers to an amount. Joel Nitikman noted that s 68 required a “reasonable” allocation of the purchase price between land and building, meaning the amount payable for each property must be determined. The use of the term “reasonable” in s 245(2), however, refers not to quantum but rather, to “tax consequences.” While established case law may offer some assistance to the taxpayer in determining what amounts are likely to be considered “reasonable,” there is simply no indication as to how the taxpayer might determine the reasonableness of the imposition of joint liability, interest, penalties, or the denial of a capital gains exemption.²³ This is a highly regrettable state of affairs.

²² Joel Nitikman “Is GAAR Void for Vagueness” (1989) 37(6) Can Tax J Rev Fiscale Can 1409 at 1438.

²³ At 1438.

(c) “Tax Benefit”

Also problematic is the reference contained in s 245(1) to the concept of the “tax benefit.” Under this heading, a court is required to determine whether there has been a reduction of tax payable from a higher to a lower amount, the lower amount presumably being the amount the taxpayer had declared in his or her return. But, as Nitikman asked, what was the higher amount? Was this the amount that would have been payable had no transaction been carried out, or was it rather the amount that would have been payable had the transaction been carried out in the “normal,” “usual” or “obvious” manner? As subsection s 245(1) did not say, and as the answer could not be inferred either from the rest or the GAAR or the Act read as a whole, this was, said Nitikman, a matter of complete vagueness in the sense that no standard had been provided.²⁴

It is also noteworthy that s 245(2) refers to “*a* tax benefit” rather than “*the* tax benefit.” This appears to enable a court to deny all or any part of tax benefit which arises as a product of the transaction. Yet as Nitikman explained, before a court can deny a tax benefit, it must first calculate the size of the tax benefit itself. But, if it is impossible to determine whether a tax benefit has resulted, it will be no more possible to determine the quantum of that benefit. The result is that the vagueness inherent in the term “tax benefit” contained in s 245(1) “spills over” and also permeates the charging provision, s 245(2).²⁵

(d) Subsection 245(4) and the Concepts of “Misuse” and “Abuse”

Section 245(4) is perhaps the most controversial component of the Canadian GAAR. This is because it enlists the aid of the concepts of “abuse” and “misuse.” How these terms should be understood however, is not apparent from the section itself. Nitikman regarded the concept of a “misuse” of a provision of the Act as impermissibly vague, both in the sense that no intelligent person could derive a meaning from it, and also in that it provided no intelligible standard by which a taxpayer’s actions could be judged. In the absence of such a standard, how is a taxpayer to know if his or her actions would constitute a “misuse” of the provisions of the Act? The same may be said of the concept of “abuse.” It is neither clear how a taxpayer might determine whether or not he or she had committed an abuse nor what the taxpayer might be said to have abused. Where the first part of s 245(4) refers to the misuse of a provision of the Act, the second part refers only to an “abuse” “having regard to” the provisions of the Act. But what is the taxpayer meant to have committed an abuse of? Standards of decency, the tax system, or some abstract notion of fair play?²⁶ In this respect, the section itself would unfortunately seem to provide few answers.

²⁴ At 1437.

²⁵ At 1438.

²⁶ At 1443.

F Difficulties arising from the Application of s 245

Where the previous matters related to the conceptual problems contained within the GAAR itself, the following points have more to do with its application generally. Some of these matters are further discussed in connection with the discussion of the case law which follows.

(a) Is Any Transaction Safe?

Is there any form of transaction that could logically escape the clutches of the GAAR? This is a question worth asking, as presumably, the only transaction which will not attract the attention of the GAAR is the one that does not confer a tax benefit. Therefore, for the taxpayer to be sure that his or her arrangement will not fall prey to the GAAR, he or she must ensure that the transaction or arrangement represents the highest tax position possible. However, owing to the infinite number of ways by which a given end might be accomplished, it is not clear whether such a feat is in fact possible. This would suggest that the liability of taxpayers under the GAAR is not merely ambiguous, but potentially indeterminate. No one, in other words, can say with certainty when it will apply or if it has been applied appropriately.

(b) “Doing Violence to the Language”

The application of the GAAR may also result in what might be described as a secondary “spill-over effect” whereby confusion and ambiguity are created and increased within the law. Where Nitikman spoke of ambiguity “spilling over” from one provision to another within the GAAR itself, the writer would use the modified version of the term to refer to the tendency of case law involving the GAAR to cast doubt upon other terms and concepts within the tax law, particularly where the meaning of these had not previously been contentious (equally, this could be framed in terms of what Michael Littlewood termed “doing violence to the language”²⁷).

(a) Purpose and Effect

Section 245 also risks the confusion of purpose and effect. While it is one thing to say that carrying out a particular transaction or arrangement has resulted in a tax benefit, it is quite another to say that the taxpayer acted with the intention of bringing this about.²⁸ The only safeguard against such an outcome is the bona fide purpose exemption contained within s 245(3), which might be taken to suggest that a consideration of the motivations of the taxpayer may be relevant. However, in the absence of further insight into what s 245(3)

²⁷ Michael Littlewood “Tax Avoidance, the Rule of Law and the New Zealand Supreme Court” [2011] NZ L Rev 35 At 53.

²⁸ See Trebilcock’s work as explained in Chapter Three.

means in referring to bona fide purposes, it is no more apparent that transactions carried out for “illegitimate” reasons will be classified as “avoidance transactions” than it is that transactions carried out for “legitimate” reasons will not be.

(c) The Risk of Ad Hoc Decision Making

The indeterminate scope of s 245 also tends to present a challenge to the formulation of a consistent approach to its application. Indeed, as will be seen, even where an “approach” to a GAAR may be formulated, its ability to inform and guide taxpayers will almost certainly be dubious. Accordingly, the application of the GAAR risks being unprincipled and erratic.

G McNichol v The Queen: The Debut of s 245

The case of *McNichol v The Queen* (*McNichol*)²⁹ represents the debut of the present Canadian GAAR, s 245.

1 McNichol: The Facts

In *McNichol*, the appellants were partners in a law firm and equal shareholders in Bec Holding Corporation Limited (Bec). Bec was a company that had been formed in order to construct and own the building in which the appellant practiced. However, following disagreements between the partners, the appellants sought to dissolve Bec and distribute the profits among themselves. The office building was sold to the nominees of Six-44 Main Inc, and the resulting capital gain distributed to the four appellants. The appellants then sold their shares in Bec to Beformac Holdings Limited for \$300,000 of which the appellants received \$75,000 each. The taxpayers reported their sale of shares as a disposition of capital property, and reported as a capital gain the excess of \$75,000 over the adjusted cost base of their shares in their respective 1989 personal tax returns and sought to claim a capital gains exemption under the former s 110.6(3) of the Canadian ITA 1985 (the Act).³⁰ Consequently, while two of the appellants paid a small amount of tax on their dispositions, the other two paid no tax at all.

The Minister of National Revenue (the Minister), however, viewed this arrangement with disfavour and reassessed the appellants under s 245 as if they had received taxable dividends instead. The Minister also invoked ss 84(2) and 84.1 as grounds for treating the amounts received by the taxpayers as dividends. Although the Tax Court of Canada held that ss 84(2) and 84.1 had no application, s 245 was found to apply and the taxpayers’ appeal was accordingly dismissed.

²⁹ *McNichol v The Queen* [1997] 2 CTC 2088.

³⁰ Income Tax Act RSC 1985, c 1 (5th Supp).

2 *The Decision of the Tax Court*

As *McNichol* was the first time a court had been called to contend with s 245, the approach taken by the Tax Court Judge is a matter of some significance. His Honour, Bonner TCJ, began by considering whether a tax benefit had arisen. His Honour wrote that there was “nothing mysterious” about the concept of the tax benefit contained within s 245(1). While there might be difficulties in identifying the “norm or standard” against which the reduction was to be measured in other cases, there was, his Honour held, no such difficulty in the present case. The benefit sought by the appellants was, in his Honour’s view, “the difference between tax payable by the appellants upon receipt of taxable dividends and that payable upon realization of capital gains from the disposition of shares.”³¹

His Honour then turned his attention to whether the sale of the shares was a transaction that might reasonably be considered to have been undertaken primarily for bona fide purposes other than to obtain the tax benefit within the meaning of s 245(3), and concluded that the sale of shares had been selected “not for bona fide reasons,” but rather as “an apparent capital gain and consequent eligibility for a deduction...”³² Finally, Bonner TCJ sought to determine whether the transaction represented a misuse of the provisions of the Act or an abuse having regard to these as a whole under s 245(4), and found that the transaction was in fact caught by s 245.³³ That said, however, *McNichol* presents several difficulties which would appear to spring chiefly from the problems already identified with Canada’s GAAR.

3 *Questions of McNichol*

(a) The “Tax Benefit”

Consider the court’s insistence that there was “nothing mysterious” about the concept of the tax benefit in *McNichol*. As explained earlier, s 245 contains no guidance as to how the higher tax position is to be determined. However, in the court’s view, the appellant taxpayers had two choices; a liquidating dividend or the sale of the shares. Yet the court’s approach is difficult to reconcile with appellants’ argument that, in the event that they had liquidated their investments by way of dividend, they would have augmented the distribution from Bec by way of a “dividend refund” which would have accrued to Bec and, indirectly, to its shareholder.³⁴

³¹ *McNichol*, above n 29, at [20] per Bonner TCJ.

³² At [21] per Bonner TCJ.

³³ At [25] per Bonner TCJ.

³⁴ At [26] per Bonner TCJ.

While the assessor for Revenue Canada was evidentially aware of this possibility, he expressed his reasons for not adopting this position as follows:³⁵

I did give consideration to it. And one of the reasons that we didn't go down that route is that a portion of that difference, whether it's half or whatever, relates to the refundable dividend tax on hand, which is still available in – which flowed through on this share sale to, I guess – well, through the amalgamation, it flows through to the amalgam of the company. Still available to be withdrawn. And that was, I guess, basically, the Department's position as to why they didn't choose that route.

Although confusing, these remarks would tend to suggest that the Revenue Canada's conception of the counterfactual was not necessarily based on how the taxpayers might have acted in the alternative, but rather on the likely tax effect that the counterfactual would have. Was it the arrangement at which the Revenue was aiming, or rather the result? The matter is regrettably unclear.

(b) Purpose and Effect

Section 245(3) also presented problems. The court found that it was for the taxpayers to satisfy the court that they had acted for bona fide purposes. While counsel for the taxpayers had argued that the main purpose of the sale of the appellants' shares was to terminate their association with one another in the common ownership of Bec,³⁶ in the absence of any guidance or information as to the list of "approved" purposes which would satisfy the court that they had acted for bona fide purposes, how were the taxpayers to know in advance whether they had? How was the court to know that they had not? The rationale underpinning Court's decision is unclear.

(c) "Misuse"

Also apparent were the difficulties presented by the concepts of "misuse" and "abuse." It is not clear how the Court reached the conclusion that the transaction had resulted in a misuse and abuse of the provisions of the Act, or by what standard the matter was determined. Unfortunately, very little guidance was forthcoming on this point.

H The Advent of Canada Trustco v The Queen and Mathew v The Queen

The approach of the Canadian courts to s 245 has altered significantly since *McNichol*.³⁷ This is in no small part due to the judgments of the Supreme Court in *Canada Trustco Mortgage*

³⁵ At [26] per Bonner TCJ.

³⁶ At [21].

³⁷ Readers may be interested to read the decisions of *Shell Canada Ltd v R* [199] 3 SCR 622 and *OFSC Holdings v R* (2001) FCA 260.

Co. v The Queen (Canada Trustco),³⁸ and its “companion” case of *Mathew v The Queen (Mathew)*.³⁹ The outcomes of the two cases differ starkly; where *Canada Trustco* was decided in favour of the taxpayer, the case of *Mathew* went in favour of the Revenue.

1 *Canada Trustco: The Facts*

In 1996 Canada Trustco Mortgage Company (CTMC) purchased a number of trailers from Transamerica Leasing Inc (TLI) for the fair market value of C\$120 million with the aid of a loan of approximately C\$100 million from the Royal Bank of Canada (RBC). The trailers were leased to Maple Investments Limited (MAIL) which in turn subleased the trailers to TLI, the original owner. TLI prepaid the full amount owing to MAIL under the sublease. MAIL placed on deposit with the RBC an amount equal to the loan for the purpose of making the lease payments. A bond was also pledged as security in order to guarantee a purchase option payment to CTMC at the conclusion of the lease. These transactions entitled CTMC to capital cost allowance (CCA) deductions by which it could shelter other income from tax and also acted to significantly reduce its financial risk.⁴⁰

The Minister reassessed CTMC on its 1997 taxation year and denied its claim for approximately C\$32 million on the grounds that CTMC had not acquired title to the trailers, and in the alternative, that the GAAR, s 245, applied to deny the deduction (the Minister, however, later abandoned the first ground). The Tax Court⁴¹ found in favour of the taxpayer, a decision which was upheld by the Federal Court of Appeal.⁴² The Supreme Court found similarly and dismissed the Crown’s appeal.

2 *Mathew v The Queen: The Facts*

In *Mathew*, Standard Trust Company (STC) transferred a portfolio of mortgages containing approximately C\$52 in unrealised losses to Partnership A, a non-arm’s length partnership, at their historical cost of \$85m. This was capital for a 99 percent interest in Partnership A. STC relied on s 18(13) of the Act to transfer its portfolio assets into Partnership A at their historical cost. STC then sold its 99 percent interest to an arm’s length party. Partnership B was formed in order to acquire the 99 percent interest in Partnership A. The appellants joined Partnership B and thereby claimed their proportionate shares of the losses arising from the sale or write down of the mortgaged properties and deducted these against their personal incomes. The Minister assessed the appellants and disallowed the deductions under the

³⁸ *Canada Trustco Mortgage Co v R* 2005 SCC 54.

³⁹ *Mathew v R* 2005 SCC 55.

⁴⁰ Jack Bernstein, Barbara Worndl and Kay Leung “Canadian Supreme Court’s Pronouncement on GAAR: A Return to Uncertainty” (2005) Nov Tax Notes International at 4.

⁴¹ *Canada Trustco Mortgage Co v R* [2003] 4 CTC 2009.

⁴² *Canada Trustco Mortgage Co v R* [2004] 2 CTC 276.

GAAR. The taxpayers' appeals against the Minister's assessments were dismissed by the Tax Court of Canada,⁴³ a decision which was upheld by the Federal Court of Appeal.⁴⁴ The Supreme Court of Canada also dismissed the taxpayers' appeal.

3 *The Supreme Court's approach in Canada Trustco and Mathew*

The Supreme Court laid out the principles of its approach to s 245 in *Canada Trustco*. The Court affirmed the importance of conducting statutory interpretation in accordance with the scheme and object of the Act, and the intention of Parliament. The interpretation of a statutory provision was to be carried out according to a textual, contextual, and purposive analysis.⁴⁵

The Supreme Court regarded the ITA 1985 as an instrument dominated by explicit provisions dictating specific consequences, thus inviting a largely textual interpretation. The GAAR, by contrast, was a broadly drafted provision intended to negate arrangements that would be permissible under a literal interpretation of other provisions of the Act.⁴⁶ The GAAR, the court said, sought to draw a line between legitimate tax minimisation and abusive tax avoidance, although that line was admittedly "far from bright."⁴⁷

The court held that the application of the GAAR involved three steps. The first was to determine whether a "tax benefit" arose from a "transaction" under s 245(1) and (2). Whether a tax benefit existed was a factual determination.⁴⁸ Where a deduction was claimed, the existence of a tax benefit was clear, as a deduction resulted in a reduction of tax. In other instances, whether a tax benefit had accrued could only be established by comparison with an "alternative arrangement."⁴⁹

The second step was to determine whether that transaction was an avoidance transaction under s 245(3), in the sense of not being "arranged primarily for bona fide purposes other than to obtain the tax benefit."⁵⁰ This was said to be a factual inquiry, which, in involving reasonableness suggested the possibility of different interpretations of the events must also be considered.⁵¹ The court held that the term "non-tax purpose" had a broader scope than

⁴³ *Mathew v R* [2003] 1 CTC 2045.

⁴⁴ *Mathew v R* [2004] 1 CTC 115.

⁴⁵ *Canada Trustco*, above n 38, at [10] per McLachlin CJC and Major J.

⁴⁶ "To the extent that the GAAR constitutes a 'provision to the contrary' as discussed in *Shell* (at [45]), the *Duke of Westminster* Principle and the emphasis on textual interpretation may be attenuated."

At [13]. See also *Shell Canada Ltd v R* [1999] 3 SCR 622 (SCC).

⁴⁷ *Canada Trustco*, above n 38, at [16] per McLachlin CJC and Major J.

⁴⁸ At [19] per McLachlin CJC and Major J.

⁴⁹ At [20] per McLachlin CJC and Major J.

⁵⁰ At [21] per McLachlin CJC and Major J.

⁵¹ At [29] per McLachlin CJC and Major J.

“business purpose” as Parliament had apparently wished for many schemes which did not have a business purpose to endure.⁵² In a series of transactions, the presence of one “avoidance transaction” would serve to taint any tax benefit resulting from the series which might be denied by the GAAR.⁵³ However, the court held that the GAAR was enacted as a provision of “last resort” in order to address abusive tax avoidance, and was not intended to introduce uncertainty into tax planning.⁵⁴

The correct approach to s 245(4) was described as a two stage inquiry in which the determination of “misuse” and “abuse” were not separate inquiries.⁵⁵ At the first stage a court must interpret the provisions which gave rise to the tax benefit in order to determine their object, spirit and purpose. At the second stage of the enquiry a court was to examine the factual context of the case and determine whether the transaction fell within or frustrated the object, spirit, or purpose of the provisions at issue.⁵⁶ The Supreme Court held that the courts could not “search for an overriding policy of the Act” that was not based on a unified approach to statutory interpretation.⁵⁷ To do such a thing, the Court said, would not only be incompatible with the roles of reviewing judges,⁵⁸ but would also run counter to the overall policy of the legislature that tax law be certain, predictable and fair in order that taxpayers could intelligently order their affairs.⁵⁹

Abusive tax avoidance would be found when a taxpayer had relied upon specific provisions of the Act to achieve an outcome that those provisions sought to prevent. An abuse would result where the underlying rationale of the provisions relied upon was defeated, or when an arrangement circumvented the application of certain provisions (such as specific anti-avoidance rules) so as to defeat the object, spirit or purpose of those provisions. Abuse would not be established where it was reasonable to conclude that an avoidance transaction under s 245(3) was within the object spirit or purpose of the provisions that conferred the tax benefit.⁶⁰

The Court stated that the initial obligation was on the taxpayer to “refute” or challenge the Minister’s factual assumptions, either by contesting the existence of a tax benefit or by demonstrating that a bona fide non-tax purpose primarily drove the transaction.⁶¹ It was not,

⁵² At [33] per McLachlin CJC and Major J.

⁵³ At [34] per McLachlin CJC and Major J.

⁵⁴ At [21] per McLachlin CJC and Major J.

⁵⁵ At [43] per McLachlin CJC and Major J.

⁵⁶ At [44], [55] per McLachlin CJC and Major J.

⁵⁷ At [41] per McLachlin CJC and Major J.

⁵⁸ At [41], [42] per McLachlin CJC and Major J.

⁵⁹ At [42] per McLachlin CJC and Major J.

⁶⁰ At [45] per McLachlin CJC and Major J.

⁶¹ At [63] per McLachlin CJC and Major J.

the Court said, unfair to impose such a burden, as the taxpayer would presumably have knowledge of the factual background of the transaction. However, in respect of the inquiry into abusive tax avoidance under s 245(4), the Court held that it was for the Minister to identify the object, spirit or purpose of the provisions claimed to have been frustrated or defeated.⁶² The abusive nature of the transaction was to be “clear.”⁶³

In *Mathew*, the Supreme Court found against the taxpayers. The court held that their abusive nature of the transactions was confirmed by the “vacuity” and “artificiality” of the non-arm’s length aspect of the initial relationship between Partnership A and STC. The purposive interpretation of ss 18(3) and 96(1) indicated that they allowed the preservation and sharing of losses on the basis of shared control of assets in a common business activity. The absence of such a basis led to an inference of abuse.⁶⁴ In *Canada Trustco* the Court found for the taxpayer, holding that the application of the same approach led away from the Crown’s contention that the term “cost” should be understood as the “amount at risk.”⁶⁵

4 Questions of the Supreme Court’s Approach to s 245

It is suggested that the approach taken toward the GAAR in *Canada Trustco* and *Mathew* presents a number of difficulties.⁶⁶

(a) Statutory Interpretation

The court in *Canada Trustco* adopted what it called the “unified textual, contextual and purposive” approach to statutory interpretation. The difficulty with this approach, however, is that it would appear to assume that its constituent components do not tend toward different conclusions. It is not clear what the court meant in using the term “textual” to denote one element of the advocated approach,⁶⁷ especially as the “unified” approach (concerned as it is with the intent of the legislature), would appear to be, for all intents and purposes, the “purposive” approach by another name. Additionally, both cases offer little, if any insight into how the court determined the purpose said to guide the application of the provisions at

⁶² At [62] - [65] per McLachlin CJC and Major J.

⁶³ At [50] per McLachlin CJC and Major J.

⁶⁴ *Mathew*, above n 39, at [62] per McLachlin CJC and Major J.

⁶⁵ *Canada Trustco*, above n 38, at [73]-[75] McLachlin CJC and Major J.

⁶⁶ Shortly after the decisions in *Canada Trustco* and *Mathew* in Canada and *Barclays* and *Scottish Provident* in the UK, Judith Freedman argued that the more recent judgments of the Supreme Court of Canada were arguably more conservative than the tax decisions of the House of Lords. See Judith Freedman “Converging Tracks? Recent Development in Canadian and UK Approaches to Tax Avoidance” (2005) 53(4) Can Tax J: Rev Fiscale Can 1038 at 1039.

⁶⁷ Note that in *Mathew*, the court criticised the appellant’s reliance on a “literal” interpretation of s 18(13). *Mathew*, above n 39, at [46] per McLachlin CJC and Major J.

issue. Consequently, for all the court said on its method, it is doubtful whether taxpayers were left any wiser.

(b) Doing Violence to the Language?

Canada Trustco and *Mathew* offer several examples of the GAAR's tendency to create uncertainty by straining and testing the language of the ITA.⁶⁸ One example is the Minister's contention in *Canada Trustco* that the term "cost" should be understood apart from its ordinary juristic meaning and rather as the "amount at risk."⁶⁹ Another example (also from *Canada Trustco*) is Court's finding that the words "in contemplation" contained within subsection 248(10) could be applied to events either "before or after" the basic avoidance transaction found under s 245(3), notwithstanding the apparently "prospective" reading given to it by a then Director of Revenue Canada.⁷⁰

Also problematic was the Supreme Court's approach was the use of the terms "artificiality" and "vacuity" to describe the dealings of the taxpayer. The difficulty with such terms lies in their ambiguous and indefinable qualities and the questions which flow from their application to specific facts. In *Mathew* these terms were used to describe the non-arm's length aspect of the initial relationship between Partnership A and STC.⁷¹ The problem with such an approach, however, is the question of how an "artificial" relationship, transaction or arrangement may be discerned from one which is, presumably, by contrast, "real." How, in other words, is the taxpayer to determine into which category his or her proposed course of dealing will fall?

(c) The Burden of Proof

There is also the matter of the Court's decision to treat the components of the tax benefit and bona fide purpose exemption as matters of fact, thereby requiring the taxpayer to shoulder the burden of proof. While the court did not consider that this would put taxpayers at any disadvantage, the problem with this view is that it is questionable whether these concepts should be treated as of a strictly factual nature as they turn on conceptual abstractions. How is the size of a tax benefit to be measured? What would constitute a bona fide purpose? As these questions remain unanswered, it is difficult to see how any concept which incorporates these abstractions can be regarded strictly as a matter of fact.

⁶⁸ Refer to the discussion of the "secondary spill-over effect," above.

⁶⁹ *Canada Trustco*, above n 38, at [72] per McLachlin CJC and Major J.

⁷⁰ *Canada Trustco*, above n 38, at [26].

⁷¹ 'The abusive nature of the transactions is confirmed by the vacuity and artificiality of the non-arm's length aspect of the initial relationship between partnership A and STC.' *Mathew*, above n 39, at [62] McLachlin CJC and Major J.

(d) “Misuse” and “Abuse” as Distinct Concepts

The court’s finding that there was no distinction between the concepts of “misuse” and “abuse” is difficult to reconcile with the use of the word “or” to separate the two in s 245(4), the implication being that a transaction may fall into either one of the categories, or both.⁷² While Professor David Duff agreed the concept of a misuse of specific provisions of the ITA could not be separated from contextual considerations arising from other provisions and the rejection of the notion of an “overriding policy,” he did take issue with the combination of the misuse and abuse analysis into a “single unified approach.” Duff argued that this both ignored the statutory language of s 245(4) and might inhibit the effective operation of the GAAR.⁷³ Perhaps the application of s 245 presented more difficulties for the Court that it cared to admit.

(e) Further Remarks

More generally, Lara Friedlander noted the extent to which it had been left to the lower courts to determine the scope of the GAAR; accordingly, many questions remained. To what extent was the purpose of the provision to be taken into account? What is the role of economic substance? When was abuse “clear?” While Friedlander regarded the principle that the GAAR should not be used as an *in terrorem* rule as having been “clearly recognised” by the Supreme Court in both cases,⁷⁴ the writer wonders whether the questions arising from the cases of *Canada Trustco* and *Mathew* might nonetheless have an effect similar to that feared. That said, however, while approach of the Supreme Court in both cases was puzzling, the outcomes themselves do not seem particularly surprising. Whether this helps matters is difficult to say.

I Along Came Lipson

The next case concerning the GAAR to appear before the Supreme Court was *Lipson v Canada (Lipson)*.⁷⁵ The result was a split decision, with no less than three judgments emanating from the seven judge panel. Consequently, the application of the GAAR would seem to pose problems not only for taxpayers but jurists also.

⁷² This view has endured – in the later case of *Copthorne Holdings v The Queen*, it was said that there was no distinction between an “abuse” and a “misuse;” there instead was a single unified approach, and that the balance of reasons, the court would only use the term “abuse.”

⁷³ David Duff “The Supreme Court of Canada and the General Anti Avoidance Rule: *Canada Trustco* and *Mathew* (2006) Feb Bulletin 54.

⁷⁴ Lara Fiedlander “Canada Trustco Mortgage Co v The Queen and Mathew v The Queen: the Supreme Court of Canada Finally Considers GAAR” (2006) 1 BTR 48 at 53.

⁷⁵ *Lipson v R* 2009 SCC 1.

1 *Lipson: The Facts*

In *Lipson*, the appellant, Earl Lipson (Mr Lipson) and his wife Jordanna Lipson (Mrs Lipson), entered into an agreement of sale and purchase for a family home in Toronto at the purchase price of C\$750,000. In August 1994, Mrs Lipson borrowed C\$562,000 from the Bank of Montreal in order to finance the purchase of 20 and 5/6 shares in the family corporation, Lipson Family Investments Limited, at fair market value. However, as Mrs Lipson did not earn sufficient income to pay the interest on this loan (the share loan), and as the bank would not have agreed to lend it to her on an unsecured basis, Mr Lipson agreed to repay the loan in its entirety the following day. Mrs Lipson paid the borrowed money to her husband, who transferred the shares to her in turn. Mr and Mrs Lipson then obtained a mortgage from the Bank of Montreal for \$562,500 (the mortgage loan), which was advanced on September 1, 1994, under which they were joint chargers. Mr and Mrs Lipson used the mortgage funds to repay the share loan in its entirety the same day. Mr Lipson sought to rely on four provisions of the Canadian Income Tax Act to claim a deduction of the mortgage loan interest on his 1994, 1995, and 1996 tax returns.

The first was s 73(1) which stated that a taxpayer might defer tax on interspousal transfers of property. As a consequence, the transfer of shares from Mr Lipson to his wife was deemed to have occurred at his adjusted cost base rather than at fair market value and Mr Lipson neither sustained a loss nor realised a gain on the sale. The second provision, s 74, attributed any income or loss from property transferred from one spouse to another back to the transferring spouse for tax purposes. This meant that despite Mrs Lipson owning the shares which she acquired from Mr Lipson, the dividend and losses were attributed to Mr Lipson instead. The third provision, s 20(3), allowed a deduction for interest on money borrowed to repay previously borrowed money if the interest on the loan was deductible; the mortgage loan was therefore treated as having funded the share purchase. Fourth, Mr Lipson relied on s 20(1)(c) in order to deduct the mortgage loan interest. This allowed the deduction of interest on money borrowed “for the purpose of earning income from a business or property.”

The Minister, however, disallowed the interest expenses for the period, contending that the series of transactions amounted to abusive tax avoidance under s 245(4). The taxpayers appealed the Minister’s reassessments to the Tax Court of Canada,⁷⁶ which dismissed their appeals, a decision upheld by the Federal Court of Appeal.⁷⁷ A majority of the Supreme Court led by LeBel J (Fish, Abella and Charron JJ concurring, Binnie and Deschamps JJ dissenting, Rothstein J dissenting) ruled in favour of the Minister.

⁷⁶ *Lipson v R* [2006] 3 CTC 2494.

⁷⁷ *Lipson v. R.* [2007] 3 CTC 110; 280 D.L.R. (4th) 714.

2 The Majority Judgment

An important component of the appellants' argument in *Lipson* was the contention that the case of *Singleton v Canada (Singleton)*⁷⁸ supported their position because of its focus on legal relationships. However, LeBel J, writing for the majority, held that *Singleton* did not apply on the grounds that neither s 74.1 of the Act, nor the GAAR, had been at issue in *Singleton*. To treat *Singleton* as dispositive would, in the majority's view, have been to "read the GAAR out of the ITA."⁷⁹

Due to the concessions made on the part of the taxpayer, the issue before the courts was the application of s 245(4). Two tax benefits were identified; first, the deductibility of interest associated with ss 20(1)(c) and 20(3),⁸⁰ and second, that arising from Mr Lipson's use of the attribution rules linked to ss 73(1) and 74.1(1).⁸¹ Following a discussion of the purpose of each provision, the court proceeded to the second step; the determination of whether the avoidance transaction frustrated the object, spirit or purpose of the relevant provisions. The entire series of transactions was to be considered in order to determine whether the individual transactions within the series abused one or more provisions of the Act.⁸² Yet the majority warned against shifting the focus of the analysis to the "overall purpose" of the transactions, lest it be implied that the taxpayer's motivation or the purpose of the transaction was determinative. The majority instead preferred the term "overall result."⁸³

While the majority did not consider the tax benefit conferred on Mrs Lipson by ss 20(1)(c) and 20(3) to be a misuse of those provisions,⁸⁴ it held that the transactions became "problematic" when the parties turned to ss 73(1) and 74.1(1) in order for Mr Lipson to apply Mrs Lipson's interest deduction to his own income. This, the majority said, was contrary to the purpose of s 74.1(1).⁸⁵ The only way that the appellants could have produced the result, the majority said, was by taking advantage of their non-arm's length relationship. As a consequence, the attribution by operation of s 74.1(1) was deemed to be abusive tax avoidance. The fact that s 74.1(1) was triggered automatically when Mr Lipson did not elect out of s 73(1), as well as the question of his motivation or purpose, were irrelevant. To allow

⁷⁸ In *Singleton*, the taxpayer had used C\$300,000 of equity in his law firm to purchase a house. The taxpayer had then refinanced his law firm equity with borrowed money and sought to deduct the interest on the grounds that the borrowed money represented his investment in the law firm. The Supreme Court had ruled in favour of the taxpayer. See *Singleton v Canada* [2001] 2 SCR 1046.

⁷⁹ *Lipson*, above n 75, [19] - [20] as per LeBel J.

⁸⁰ At [28] per LeBel J.

⁸¹ At [28] per LeBel J.

⁸² At [33], [34] per LeBel J.

⁸³ At [34] per LeBel J.

⁸⁴ At [40], [41] per LeBel J.

⁸⁵ At [41] per LeBel J.

s 74.1(1) to have been used in that way, it was said, would frustrate the purpose of the attribution rules.⁸⁶

As to the matter of uncertainty, however, the majority held that while the GAAR might “introduce a degree of uncertainty into tax planning,” such uncertainty was “inherent in all situations in which the law was applied to unique facts.” The GAAR was “neither a penal provision nor a hammer to pound taxpayers into submission” but rather “designed...to restrain abusive tax avoidance” and ensure “the fairness of the tax system is preserved.”⁸⁷ A desire to avoid uncertainty could not justify “ignoring a provision of the ITA...clearly intended to apply to transactions that would otherwise be valid on their face.”

3 *The Dissent of Binnie and Deschamps JJ*

The dissent of Binnie J (Deschamps J concurring) commenced with an expression of concern for *The Duke of Westminster* principle. The GAAR, his Honour said, was a weapon that, unless contained by the jurisprudence, could have a “widespread, serious and unpredictable effect” on legitimate tax planning.⁸⁸

In his Honour’s view, the tax plan at issue in *Lipson* could be characterised as “*Singleton* with a spousal dimension” or “*Singleton* with a twist.” Applying *Singleton*, his Honour regarded the only question posed by *Lipson* as being whether the deduction became “abusive” when income or losses were attributed back to the transferor by the spousal attribution rules in ss 73(1) and 74.1(1).⁸⁹ This, in the opinion of Binnie J, was to be answered in the negative.⁹⁰ To hold that the result of the application of the spousal attribution rules to the result anticipated by *Singleton* was improper was to say that while it was legitimate for a taxpayer to rearrange his or her capital in a tax efficient manner, it was abusive for the rearrangement to involve a sale of property at fair market value between spouses.⁹¹ It could not be right, his Honour said, that whenever a lower income spouse borrowed money to purchase shares from a higher income spouse that there was an abuse of the spousal attribution rules unless the transferring spouse opted out of ss 73(1) and 74.1(1) and thereby forfeited a tax benefit clearly available under the Act.⁹² This would mean paying

⁸⁶ At [42] per LeBel J.

⁸⁷ At [52] per LeBel J.

⁸⁸ At [55] per Binnie J.

⁸⁹ At [57] – [58] per Binnie J.

⁹⁰ At [62] per Binnie J.

⁹¹ At [59] per Binnie J. His Honour quoted approvingly from *Jabs Construction Ltd v The Queen* in which the GAAR was described as an ‘extreme section’ which was not to be used routinely, every time the Minister became ‘upset’ just because a taxpayer had structured a transaction in a tax effective way, or in a manner that did not maximise the tax. *Jabs Construction Ltd v The Queen*, 99 DTC 729 (TCC) at [48].

⁹² *Lipson*, above, n 75, at [96] per Binnie J.

lip service to *The Duke of Westminster* principle without taking seriously its role in promoting consistency, predictability and fairness in the tax system.⁹³

4 *The Dissent of Rothstein J*

Although Rothstein J agreed with the analyses of LeBel and Binnie JJ insofar as ss 20(1)(c) and 20(3) of the Act were concerned, his Honour did not accept the approach of his colleagues to the attribution rules. The Minister, his Honour said, ought not to have relied on the GAAR. This was, in his Honour's view, a provision to which he could only resort when he had no other recourse.⁹⁴ An appropriate specific anti-avoidance rule would preclude the application of the GAAR.⁹⁵

In this respect, Rothstein J held that the specific anti-avoidance rule 74.5(11) applied to the facts of *Lipson*, rather than the GAAR. That the Minister did not rely on s 74.5(11) did not, in Rothstein J's view, change the fact that the section applied in law.⁹⁶ To deal with "the proper limits of the GAAR" and leave s 74.5(11) for another day, as Binnie J had suggested, led in Rothstein J's opinion to an "unhelpful" legal analysis that ignored the applicable limits that the legislature had chosen to impose on the GAAR.⁹⁷

5 *Questions of Lipson*

(a) Statutory Interpretation

As the decision in *Lipson* illustrates, the application of the "unified textual, contextual and purposive" approach would seem not to be without difficulty. The presence of a split decision would tend to lend credence to the view that the approach set down in *Canada Trustco* lacks an intelligible standard capable of being emulated by jurists. But if the Supreme Court could not agree upon its application, then what hope exists for lower courts, legal professionals and taxpayers?⁹⁸

Doug Mathew of Thorsteinssons, Vancouver, argued that while the approach set down in *Canada Trustco* had proven to be workable, neither the majority nor minority analysis in *Lipson* fully considered the text and context of the relevant provisions. The analyses appeared to be exactly of the subjective type rejected in *Canada Trustco*. What confidence, Mathew wondered, could taxpayers have in a judicial test where one group of Canada's top jurists

⁹³ At [98] per Binnie J.

⁹⁴ At [104] per Rothstein J.

⁹⁵ At [108] per Rothstein J.

⁹⁶ At [102] – [103], [118] per Rothstein J.

⁹⁷ At [119] per Rothstein J.

⁹⁸ Jeffrey Simser "Tax Evasion and Avoidance Typologies" (2008) 11(2) JMLC 123.

held that the purpose of a provision was to explicitly permit and promote a certain outcome, while another said the purpose of the provision was to prohibit it?⁹⁹

(b) The Burden of Proof

The case of *Lipson* saw a shift in the burden of proof. As Duff noted, where the abusive nature of the transaction was once required to be “clear,” the majority of the Supreme Court in *Lipson* had only required that the Minister demonstrate that the avoidance transaction had resulted in a misuse and abuse within s 245(4) on the balance of probabilities. Although Duff regarded this as consistent with amendments to the language of the misuse and abuse test in 2005, he was not convinced that this necessarily marked a permanent shift in the approach of jurists to s 245.¹⁰⁰

(c) Doing Violence to the Language?

Lipson would also appear to demonstrate the creation of further ambiguity and the confusion of purpose and effect. Duff noted LeBel J’s finding that the misuse or abuse analysis should focus on the “overall result” of a series of transactions rather than its “overall purpose,” emphasising that motivation, purpose and economic substance were relevant to a misuse or abuse analysis to the extent that they established whether the transaction frustrated the purpose of the relevant provision.

This might be taken to either establish or confirm that there exists within Canadian tax law something similar to the concept of “objective purpose” present within the law of Australia and New Zealand.¹⁰¹ This is problematic, however, as a transaction cannot, of itself, be possessed of a purpose apart from that held by its architect. Accordingly, the enlistment of the notion would seem to represent the confusion of purpose and effect. After all, if motive is irrelevant, how else but by reference to its consequences is the purpose of a transaction to be determined?

(d) Further Remarks

The reactions of academics and commentators to *Lipson* were mixed. Duff argued that the approach of Binnie J would “seriously limit” the effectiveness of the GAAR and expressed his preference for the judgment of the majority. Duff agreed that the majority was correct to suggest that Binnie J’s approach would essentially “gut” the GAAR, reading it out of the Act “under the guise of an exercise in legal interpretation.”¹⁰² The difficulty with Duff’s

⁹⁹ Doug Mathew “The GAAR and the Disappointing Case of Mr. and Mrs. Lipson” (April 2009) Chartered Accountants of British Columbia <www.ica.bc.ca>.

¹⁰⁰ David G Duff “*Lipson v Canada*: Whither the Canadian GAAR?” (2009) 2 BTR 161 at 167.

¹⁰¹ *Newton v Federal Commissioner of Taxation* [1958] AC 450 (PC).

¹⁰² Duff, above n 100, at 167.

argument, however, is that it would seem to assume that the ambit and application of the GAAR are well established, when in fact they are nothing of the sort. Thus, what may appear to one academic as a “gutting” of the GAAR may to look to another very much like its unwarranted extension. There would, in other words, seem to be a considerable measure of subjectivity inherent in pronouncements as to the proper ambit of s 245.

This would tend to suggest that the value judgments of individual jurists play a significant role in the determination of cases involving the GAAR. This view bears parallels to that expressed by other authors such as William Innes, Chia-yi Chua and Timothy Fitzsimmons¹⁰³ who expressed the view that the “unfortunate effect” of *Lipson* had been to muddle whatever clarity had emerged from *Canada Trustco*. In their view, the majority had endorsed what came very close to a judicial “smell test.”¹⁰⁴ If correct, the application of the GAAR risks becoming increasingly difficult to predict.

J The Advent of Copthorne

The Canadian GAAR was more recently at issue in the case of *Copthorne Holdings Ltd v Canada (Copthorne)*.¹⁰⁵ The result was a victory for Revenue Canada.

1 Copthorne: The Facts

The facts of *Copthorne* are somewhat involved.¹⁰⁶ Li Ka-Shing and his son, Victor Li, controlled a group of Canadian and non-resident companies (the Li Group) which invested C\$97m in one of its Canadian members, VHHC Investments Ltd. This company purchased all the shares in VHHC Holdings Ltd for C\$67m. VHHC Holdings Ltd held shares directly and through a subsidiary corporation, VHSUB Holdings Inc, in Husky Oil Ltd. In 1991 the market value of the Husky shares fell. This resulted in an unrealised capital loss on those shares for VHSUB Holdings Inc.

Towards the end of 1991 shares in VHSUB had a nominal fair market value at an adjusted cost base of C\$84m which reflected the accrued capital loss on the Husky shares. In 1992 VHHC Investments sold its shares in VHHC Holdings with Paid-Up Capital (PUC) of C\$67m to Copthorne Holdings Ltd (Copthorne I), a subsidiary of Big City Project Corporation B.V. (Big City), a Netherlands based company and a member of the Li Group. In 1993 the Li Group wished to amalgamate Copthorne I, and its subsidiary, VHHC Holdings, as well as two other corporations. In the event that the corporations had been subject to a

¹⁰³ William I. Innes, Chia-yi Chua, Timothy Fitzsimmons, Fraser Milner Casgrain LLP “Lipson v R: The Shuffle of Cheques, Decks and Equity” (2009) Tax Litigation Volume XVI, No 2, 982-988.

¹⁰⁴ At 988.

¹⁰⁵ *Copthorne Holdings Ltd v R* 2011 SCC 63.

¹⁰⁶ For further detail, see *Copthorne*, above n 105, at [7] per Rothstein J.

vertical amalgamation the PUC of C\$67m of the shares of VHHC Holdings would have been eliminated. The decision was therefore taken to amalgamate the corporations horizontally in order to bring about the aggregation of the PUC of the corporations' respective shares. To avoid the cancellation of the paid-up capital of VHHC Holdings shares, Copthorne I sold its VHHC Holdings shares to Big City for their nominal fair market value. Copthorne I, VHHC Holdings and two other corporations were amalgamated to form Copthorne Holdings Ltd (Copthorne II), the shares of which were owned by Big City.

In response to legislative amendments which would have affected its interests, the Li Group sought to dispose of a business to another entity within the Li Group and remove the proceeds of disposition, either in whole or in part, from Canada. To accomplish this, L. F. Investments (Barbados) Ltd (L.F. Investments) was incorporated in Barbados and was used to acquire all the issued shares in Copthorne II and VHHC Investments. These two corporations and two others were amalgamated in the form of Copthorne Holdings Ltd (Copthorne III). L.F. Investments received C\$164m in Class D preferred shares (Class D shares). Following the amalgamation, Copthorne III redeemed C\$142m of its Class D shares that were held by L.F. investments. As the redemption amount was no more than the PUC of the shares, the redemption did not give rise to a dividend under the Act. As a result Copthorne III did not withhold or remit any tax on behalf of L.F. Investments.¹⁰⁷

The Minister reassessed Copthorne III and applied the GAAR to reduce the PUC of its Class D shares by C\$67m, the portion of the PUC attributable to the shares of VHHC Holdings. The Minister determined that a deemed dividend had arisen on the redemption by Copthorne III amounting to C\$58m, the proportion of the redemption attributable to VHHC Holdings PUC, 15 percent of which should have been withheld. The Minister assessed Copthorne III to tax of almost C\$9m, in addition to a penalty of 10 percent of that amount. Although on appeal the Tax Court¹⁰⁸ found in favour of the Minister, it overturned the penalty assessment. The decision of the Tax Court was affirmed by the Federal Court of Appeal,¹⁰⁹ a decision which was itself upheld by the Supreme Court of Canada.¹¹⁰

2 The Decision of the Supreme Court

The Supreme Court of Canada affirmed application of the “textual, contextual and purposive” approach toward the GAAR set down in *Canada Trustco*. Concerning the tax benefit, while Copthorne argued that a vertical amalgamation was “never a live and reasonable option” the

¹⁰⁷ At [15] per Rothstein J.

¹⁰⁸ *Copthorne Holdings Ltd v R* [2008] 1 CTC 2001.

¹⁰⁹ *Copthorne Holdings Ltd v R* [2009] 5 CTC 1.

¹¹⁰ *Copthorne*, above n 105.

Court upheld the finding of the Tax Court Judge that this would have been the simpler course of action and, accordingly, affirmed the existence of a tax benefit.

As to whether the transactions were avoidance transactions, although Copthorne had argued that the transactions were undertaken in order to simplify the Li Group companies and use losses within the four amalgamated companies to shelter gains, this did not, in the Court's view, explain the sale of VHC Holdings shares to Big City. The Court regarded this as the introduction of an additional step into a process of simplification and consolidation; a vertical amalgamation would have achieved the same result. Moreover, the Court said, Copthorne had not shown why sheltering gains using losses within the four companies would not have been possible if the companies had been amalgamated vertically.¹¹¹ Copthorne had failed to prove the existence of a bona fide non-tax purpose.¹¹² Accordingly, the finding that one transaction in the series which produced a tax benefit was an avoidance transaction meant the requirements of s 245 had been met.

As to whether the avoidance transaction was abusive, the Court concluded that s 87(3) recognised both horizontal and vertical amalgamations as options, and did not expressly preclude a taxpayer from selecting either. However, the Court concluded that the object, spirit and purpose of s 87(3) was to preclude the taxpayer from preserving PUC upon amalgamation where such preservation would allow a shareholder, on redemption of shares by the amalgamated corporation, to be paid amounts without liability for tax in excess of the investment of tax paid funds.¹¹³ Accordingly, the Court agreed with the Tax Court's finding that the taxpayer's "double counting" of PUC was abusive. The taxpayer had structured the transactions so as to "artificially" preserve the PUC in such a way as to frustrate the purpose of s 87(3).¹¹⁴

3 Questions of Copthorne

(a) Statutory Interpretation

Copthorne would chiefly seem to represent an effort to clarify and endorse many of the elements which emerged from *Canada Trustco*. While the Court emphasised the application of the "unified" textual, contextual and purposive approach to statutory interpretation, Brian Studniberg drew attention to the distinction Rothstein J drew between this approach and that which was to be applied in ascertaining the "object, spirit or purpose" of the provisions relied upon for the tax when considering whether the transaction represented a misuse or abuse of

¹¹¹ At [62] per Rothstein J.

¹¹² At [62], [63] per Rothstein J.

¹¹³ At [126] per Rothstein J.

¹¹⁴ At [127] per Rothstein J.

the Act.¹¹⁵ This confuses matters considerably, and would tend to suggest that the application of the “unified” approach is somewhat paradoxically itself of less than universal application.

(b) Doing Violence to the Language

A controversial element in *Copthorne* was the Court’s decision to construe the term “contemplation” retrospectively as well as prospectively, notwithstanding the evidence adduced by the taxpayer to the contrary (included among which was a statement supporting the taxpayers view made by a then Director of the Revenue Canada). What implications, if any, does this have for the extent to which taxpayers may act with confidence upon advice issued by Revenue Canada? How useful a guide is future advice likely to prove if it is readily disregarded by jurists?

(c) Implied exclusion

Studniberg also drew attention to the Court’s treatment of the taxpayer’s implied exclusion argument. In essence, the taxpayer had contended that the fact that Parliament had enacted a number of provisions to prevent taxpayers from preserving PUC inappropriately mitigated against the argument that the arrangement in question was abusive. However Rothstein J, while accepting that in some instances this might be the case, opined that the taxpayer’s view was “misplaced” where it had relied exclusively on the text of the provisions without regard to their underlying rationale.¹¹⁶

Although Studniberg regarded Rothstein J’s statement as correct, his answer had not explained how to identify that rationale where the text of the Act had not clearly established the Act’s purpose.¹¹⁷ In this respect, Studniberg makes an excellent point. A prevailing theme throughout the discussion of Canada’s GAAR jurisprudence has been the apparent inability of the Supreme Court to provide a guide to the application of the GAAR capable of being readily emulated by taxpayers. This is highly unfortunate and detrimental to the value of certainty within tax law.

K Canada Revenue Agency’s Advice

Much like the UK and New Zealand, the Canada Revenue Agency (CRA) also provides information to taxpayers through its website. This includes information relating to tax avoidance,¹¹⁸ and a general explanation of the operation of s 245 is also available.¹¹⁹ This,

¹¹⁵ At [70] per Rothstein J. See Brian M Studniberg “Minding the Gap in Tax Interpretation: Does Specificity Oust the General Anti-Avoidance Rule Post-*Copthorne*?” 38(1) Queen’s LJ (2012) at 231.

¹¹⁶ *Copthorne*, above n 105, per Rothstein J.

¹¹⁷ Studniberg, above n 115, at 232.

¹¹⁸ CRA “Tax Avoidance” (10 November 2005) <www.cra.arc.gc.ca>.

however, is of a general nature and by no means comprehensive. In this respect, more specific information would likely offer taxpayers greater assistance in understanding the extent of their liabilities. It is worth noting, however, that the matter of tax avoidance has been in the headlines recently, with Gail Shea, Minister of National Revenue, announcing measures designed to address international tax evasion and avoidance.¹²⁰ This may signal a more aggressive approach on the part of the CRA toward structures which it considers to avoid tax.

L Findings

Canada's experience with the use of a GAAR presents a number of important themes, and it is these which, along with those of the UK and New Zealand, form the basis of the findings presented in Chapter Seven. Before concluding, however, a brief summation of these as they relate to Canada would seem necessary.

Concerning Canada's GAAR itself, the components contained within s 245 can only be described as ill-defined and conceptually abstract. The central tenets or defining characteristics of the "tax benefit," and the "avoidance transaction" are neither present within the section itself, nor have ever been articulated by the courts. How is the presence of a tax benefit to be determined? What constitutes a bona fide purpose? By what standard are these to be determined? The fact that the taxpayer bears the onus of contesting the existence of both a "tax benefit" and an "avoidance transaction," only makes matters worse. In the absence of clear definitions, how is it imagined that the taxpayer might demonstrate the contrary position?

The concepts of a "misuse" or "abuse" of the Act are similarly abstract; so much so in fact that they are, for all intents and purposes, completely meaningless. While the courts have held that it is for the Minister to demonstrate that a "misuse or abuse" of the Act has occurred, the burden of proof which the Minister must shoulder in order to do so has fluctuated, first from the "clear and unambiguous" standard given in *Canada Trustco* in 2005 to the lower standard of "on the balance of probabilities" in *Lipson* in 2009. While following the case of *Copthorne* in 2011 this has reverted back to the standard laid down in *Canada Trustco*, the absence of consistency is concerning.

The Supreme Court's approach statutory interpretation has likewise presented difficulties. In *Canada Trustco* the Court developed the "unified" approach, under which a textual, contextual and purposive approach were combined under one heading. Yet how these apparently disparate concepts are to be reconciled with one another is unclear; indeed, might

¹¹⁹ CRA "General Anti-Avoidance Rule – Section 245 of the IT" (27 August 2002) <www.cra-arc.gc.ca>.

¹²⁰ See Ernst and Young "Tax Alert – Canada" No 22 (13 May 2013).

not these components, if employed in isolation, in fact lead in different directions? If so, how did they come to be incorporated into a single approach? What has a “textual” approach to statutory construction in common with a “purposive” approach? If a “contextual” approach is broadly similar to a “purposive” approach, then why were these listed separately? Should the “unified approach” therefore be taken to indicate the adoption of an approach which is conservatively purposive or one which is textually liberal? Would there be a difference in either case?

As there would seem few answers in this respect, one might query why the Supreme Court elected to formulate a new approach in *Canada Trustco* rather than retain the broadly purposive approach which followed in the wake of the 1984 case of *Stubart*. Why it did not is unapparent. Then, there is the matter of “functionality” arising from the use of the GAAR in conjunction with the purposive approach. How, in other words, can an arrangement have “tax effect” and produce a tax benefit capable of being struck down by the GAAR while simultaneously existing outside the object and spirit of the provisions upon which it relies? While this problem is not unique to Canada’s GAAR, it is still one which is present nonetheless.

The use of Canada’s GAAR has acted to increase ambiguity in the tax law, either by casting doubt on the meaning of existing terms, or through the creation of new concepts which are left undefined. For instance, In *Canada Trustco*, the revenue contended that the term “cost” should be understood not in its ordinary sense, but rather, in terms of the “amount at risk.” That the Supreme Court in *Canada Trustco* characterised the existence of a “tax benefit” and an “avoidance transaction” as matters of fact has also arguably been to the detriment of the nature of the concept of matters of “fact.” The case of *Mathew* saw the Supreme Court refer to the concepts of “vacuity” or “artificiality” without explaining what these meant. Additionally, in both *Canada Trustco* and *Copthorne* the phrase “in contemplation” was read both “prospectively” and “retrospectively” notwithstanding the existence of evidence from a then Director of Revenue Canada suggesting that it ought to be read “prospectively” only.

There is also the question of the relationship between the GAAR and specific anti-avoidance provisions. In *Lipson* the issue of the interplay between s 245 and the specific anti-avoidance provision s 74.5(11) came to the fore. This matter was the cause of some disagreement between the judges, and only served to add to the uncertainty in relation to the scope of s 245’s application. Similarly, in *Copthorne* the taxpayer’s implied exclusion argument was cast aside for reasons which are not particularly clear.

Also significant is the split decision which resulted from the case of *Lipson*, in which three separate judgments were produced by the seven judge panel. This would tend to suggest that

the GAAR presents as many difficulties for jurists as it does for taxpayers. Judicial discretion may therefore play a significant role in its application.

The determination of the counterfactual the revenue employs in ascertaining the quantum of the “tax benefit” has also proved problematic. This was most noticeable in the case of *McNichol* in which it was unclear as to how the revenue reached its conclusion, and why it chose not to adopt the taxpayer’s proffered alternative. Accordingly, there is the risk that it is not “arrangements” at which the revenue strikes, but rather “outcomes.” These and other matters are the subject of further discussion in Chapter Seven.

M Conclusion

Since the case of *Stuart*, the approach taken by Canada’s judiciary to cases of tax avoidance has generally been conservative and cautious. However, Canada’s GAAR, s 245, is an instrument which, unless applied with care, may come to pose a significant challenge to the value of certainty within Canadian tax law, if indeed it has not come to do so already.

The provisions of s 245 are ambiguous, and the terms upon which it relies are abstract and ill defined. Perhaps, in providing such an aggressive instrument in the form of s 245, Canada’s Legislature hoped that the courts might be encouraged to take a more activist approach in striking down “offending” arrangements. Yet for better or for worse, *The Duke of Westminster* principle has remained an important component of Canada’s tax law. Indeed, the presence of this principle has perhaps served to moderate the influence of s 245.

The central difficulty posed not only by Canada’s GAAR, but by all such general legislation, is that it is almost impossible for taxpayers to know whether their proposed course of dealing will be caught within its ambit. Accordingly it is hoped that Canada might one day move toward a greater balance between the exercises of specific as well as general, rules.¹²¹ Canada, in the writer’s view, would be well advised to tread carefully.

¹²¹ Readers may be interested to see Brian M Studniberg’s remarks on the interaction between the GAAR and specificity in his article “Minding the Gap in Tax Interpretation: Does Specificity Oust the General Anti-Avoidance Rule Post-*Cophorne*?” 38(1) (2012) Queen’s LJ 209.

VI NEW ZEALAND

A Introduction

1 Considering New Zealand

New Zealand's experience with a general anti-avoidance rule dates back over one hundred years. The precursor of modern general anti-avoidance legislation was s 62 of the Land Tax Act 1878 (LTA 1878), which dealt only with Land Tax and rendered covenants or agreements contrary to the intent of the Act "void and of no effect as between the parties thereto."¹ While not free from ambiguity, the avoiding effect of the section was apparently understood as limited to the parties, rather than relating to or affecting the liability of the landowner to the Crown.²

The Land and Income Tax Assessment Act 1891 was the first statute to deal with income tax. Significantly, however, in s 40 it contained a provision similar to s 62 of the LTA 1878 which declared any covenant or agreement purporting to alter the nature of an estate or interest in land for the purpose of defeating the payment of tax "void and of no effect." Section 40 was in turn replaced by s 82 of the Land and Income Assessment Act 1900 (LITAA 1900). Section 82 was described by Lord Wilberforce as the "parent" of s 108 of the Land and Income Tax Act 1954 (LITA 1954) (and also of s 260 of the Australian Income Tax Assessment Act 1936),³ and its essence (albeit with some modifications) remained in s 103 of the Land and Income Tax Assessment Act 1908, s 162 of the Land and Income Tax Act 1916 and s 170 of Land and Income Tax Act 1923.⁴

Section 108 of the LITA 1954 provided that arrangements that had the purpose or effect of altering the incidence of income tax were "absolutely void." In so far as its drafting is concerned, s 108 of the LITA 1954 with its short, succinct language, and resort to words and phrases such as "arrangement," "purpose or effect" and "liability" shares many similarities with modern general anti-avoidance rules, particularly New Zealand's present incarnation, s BG 1 of the Income Tax Act 2007 (ITA 2007).

There are also two further matters worth noting. Questions as to the scope of the general anti-avoidance rule often arose, specifically those of whether the section was fiscal, inter partes or both. While s 82 of the LITA 1900 had once employed the use of the words "absolutely void"

¹ *Mangin v Commissioner of Inland Revenue* [1971] 2 WLR 739 at 746 per Lord Donovan.

² At 753 per Lord Wilberforce.

³ At 753, 754 per Lord Wilberforce.

⁴ Section 108 was said by Lord Donovan to have been in the same form as s 170 of the Land and Income Tax Act 1923, save for the omission of the reference to "land tax." At 748.

to describe the consequences which were to befall an offending arrangement, the removal of any reference to “the parties” doubtless caused questions as to how far the application of the section might be extended.⁵ Australia, in 1936, added to its general anti-avoidance rule the words “as against the Commissioner,” a phrase also adopted by New Zealand in 1968, which, so far as Lord Wilberforce was concerned, had the effect of rendering the section purely fiscal.⁶

2 Order of Procession

In examining the New Zealand position, this Chapter begins with a discussion of the Privy Council case of *Mangin*⁷ before proceeding to a brief examination of the elements contained in New Zealand’s GAAR. It then proceeds to consider the case of *Challenge*,⁸ which ushered in the “scheme and purpose approach” to statutory interpretation. Attention is turned to the cases of *Auckland Harbour Board*,⁹ *Miller*,¹⁰ *BNZ Investments No 1*,¹¹ and *Peterson* (the latter of which was, incidentally, the last New Zealand tax case to be heard by the Privy Council).¹²

Time is then given to an examination of *Ben Nevis*,¹³ which is perhaps most famous for the development of the “parliamentary contemplation” test. It then delves into the case of *BNZ Investments No 2*,¹⁴ and the more recent cases of *Penny and Hooper*,¹⁵ *White*¹⁶ and *Alesco*.¹⁷ This is succeeded by a consideration of some of the issues arising from Inland Revenue’s Draft Interpretation Statement.¹⁸ A summary of findings and conclusion follow.

B The Advent of Mangin

The case of *Mangin v Commissioner of Inland Revenue (Mangin)*¹⁹ represented the debut of s 108 of the LITA 1954. Heard before the Privy Council, the outcome of the case resulted in a

⁵ *Mangin*, above n 1, at 753, 754 per Lord Wilberforce.

⁶ At 754 per Lord Wilberforce.

⁷ *Mangin v Commissioner of Inland Revenue* [1971] 2 WLR 739.

⁸ *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1986] 2 NZLR 513.

⁹ *Commissioner of Inland Revenue v Auckland Harbour Board* [2001] 3 NZLR 289.

¹⁰ *Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316.

¹¹ *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450 [*BNZ Investments No 1*]

¹² *Peterson v Commissioner of Inland Revenue* [2006] 3 NZLR 433.

¹³ *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC).

¹⁴ *BNZ Investments v Commissioner of Inland Revenue* (2010) 24 NZTC 23,997 [*BNZ Investments No 2*].

¹⁵ *Penny v Commissioner of Inland Revenue* [2012] 1 NZLR 433.

¹⁶ *White v Commissioner of Inland Revenue* (HC) (2010) 24 NZTC 24,600.

¹⁷ *Alesco New Zealand Ltd and Ors v Commissioner of Inland Revenue* [2013] NZCA 40.

¹⁸ Inland Revenue, below, n 215.

¹⁹ *Mangin*, above, n 7.

split decision between the majority view, delivered by Lord Donovan, and the dissent of Lord Wilberforce.

1 Mangin: The Facts

The facts of *Mangin* concerned a farmer, Mr Mangin, who had in 1965 created a “paddock trust” under which he leased a section of his farmland for one year to trustees for the purpose of cultivation. A separate trust deed required that any resulting income be held on trust for the wife and children of the appellant. As an employee of the trustees, the appellant harvested and sold the resulting wheat crop, accounting for his labour to the trustees for the proceeds, and receiving in turn recompense from the trustees both for his labour and the expenses he incurred. The bulk of the net income was then distributed by the trustees to the appellant’s wife for the benefit of herself and her children. In 1966, a similar transaction took place in relation to another area of land.

As a result of these transactions, a proportion of what would have been the appellant’s total income from his farm was “hived off”²⁰ and (via the trustees) became the income of his wife and children, allowing the beneficiaries to claim allowances and reduced rates of tax. In this way, the appellant mitigated the amount of tax that would otherwise have been payable. However, the Commissioner of Inland Revenue (Commissioner) did not regard these transactions with fondness, and made amended assessments on the taxpayer under s 108 of the LITA 1954 for the years ending 31 March 1966 and 1967, seeking to restore his income tax liability to what it would otherwise have been but for the use of the “paddock trusts.” The taxpayer successfully appealed the Commissioner’s assessments to the Supreme Court,²¹ only to have them reinstated at the Court of Appeal. The taxpayer appealed to the Privy Council, where a majority (Lord Wilberforce dissenting) dismissed the appeal.²²

2 The Majority Judgment

The majority regarded the case chiefly as one of statutory interpretation, and the true construction of s 108. First, their Lordships held, the words were to be given their “ordinary meaning” and should not be given some other meaning where their object was to frustrate

²⁰ At 745 per Lord Donovan.

²¹ It is important to note that the “Supreme Court,” of New Zealand was, at the time, the modern day equivalent of the New Zealand High Court, and was renamed the High Court in 1980. The Court of Appeal has existed since 1862 and although initially comprised of judges of the then “Supreme Court,” was permanently established in Wellington in 1957. The Judicial Committee of the Privy Council served as New Zealand’s highest appellate court until it was succeeded by the Supreme Court of New Zealand on 1 January 2004. For further information see Courts of New Zealand “The History of the Supreme Court”

<www.courtsofnz.govt.nz>.

²² *Mangin*, above n 7

“legitimate tax avoidance devices.” Moral precepts were not applicable to the interpretation of Revenue Statutes.²³ Second, their Lordships affirmed the sentiments of Rowlatt J, expressed in *Cape Brandy Syndicate v Inland Revenue Commissioners*²⁴ that there was no equity about a tax, and nothing was to be read in or implied. Rather, one could “only look fairly at the language used”

Third, given the object of the construction of a statute was to ascertain the will of the legislature, it could be presumed that neither injustice nor absurdity was intended. Therefore, where a literal interpretation would produce such a result, and the language admitted an interpretation that would avoid it, then that interpretation might be adopted. Fourth, their Lordships regarded as relevant to the construction of an enactment the historical context in which it was passed.²⁵ Their Lordships’ view was that the facts clearly presented a scheme “devised for the sole purpose, or at least the principal purpose,” of allowing the taxpayer to escape liability to tax for a substantial part of the income that he would have derived in the absence of the scheme.

3 *The Dissenting Judgment of Lord Wilberforce*

In contrast to the opinion of the majority Lord Wilberforce expressed the view that the appeal of the taxpayer should succeed. Perhaps most significant are the remarks which his Lordship offered on the deficiencies of s 108.

First, his Lordship held, s 108 failed to define the nature of the liability to tax, the avoidance of which was attacked. Was this an accrued liability, a future but probable liability, or a future hypothetical liability? One that must have arisen in the absence of the arrangement, or one that might? And if might, by what standard was this to be determined?²⁶ Second, his Lordship opined that s 108 failed to specify the circumstances in which arrangements which had fiscal consequences were outside the section, or on whom the onus lay to establish these circumstances; the result was a “jungle of words.”²⁷ Third, s 108 did not adequately articulate the connection between itself and specific provisions.²⁸ Fourth, it gave rise to difficulties in respect of the state of affairs that was to exist following the tax avoidance element of the arrangement.²⁹

²³ At 746 per Lord Donovan.

²⁴ At 746 per Lord Donovan. See also *Cape Brandy Syndicate v. Inland Revenue Commissioners* [1921] 1 KB 64 at p 71 .approved by Viscount Simons L.C. in *Canadian Eagle Oil Co. Ltd v The King* [1946] AC 119 at 140.

²⁵ *Mangin*, above n 7, at 746 per Lord Donovan.

²⁶ At 755 per Lord Wilberforce.

²⁷ At 755 per Lord Wilberforce.

²⁸ At 756 per Lord Wilberforce.

²⁹ At 756 per Lord Wilberforce.

Overall, his Lordship held that the limits of judicial interpretation were passed when one came to apply New Zealand's GAAR. This led Lordship to describe s 108 as "a rusty instrument which breaks in our hands and is no longer capable of repair."³⁰ The difficulties presented by section 108 would seem to have been, in his Lordship's view, so grievous as to render them beyond the ability of the courts to remedy.

4 *Questions of Mangin*

(a) Statutory Interpretation

What is noteworthy about their Lordships' approach to statutory interpretation is that the notion of the will of legislature would appear to have existed primarily as a practical tool for resolving the presence of ambiguity or absurdity. That said, it is somewhat difficult to understand why the majority in *Mangin* spoke of s 108 as though it could in anyway be regarded as capable of being applied in accordance with the then accepted principles of statutory interpretation. After all, if its target, tax avoidance, was not explained or articulated in any meaningful way by the GAAR (as Lord Wilberforce contended), how then could the principles of statutory construction be enlisted to assist in its application?

(b) The Elusive Nature of the Liability

The majority appeared confused about the nature of the liability to tax which s 108 targeted. While the taxpayer had contended that s 108 referred only to accrued liabilities to tax, and not liabilities that may be expected,³¹ the majority held that s 108 must be directed at arrangements which the taxpayer entered into order to "distribute the legal incidence of tax upon his income that he himself will pay less."³² The assumption underpinning this reason, however, would seem to be that the taxpayer would have entered into the arrangement in the "conventional" manner in the event that he had not acted as he did, rather than engaging in an alternative arrangement, or instead doing nothing. This element of the majority's approach doubtless contributed to motivate Lord Wilberforce's inquiry as to what form of liability s 108 referred, and how this was to be ascertained.

(c) The Risk of Judicial Legislation

The majority stated that it was mindful that judges, in searching for a means of applying s 108 which was both workable and just, approached the line where interpretation ceased. While this was a line which their Lordships held it was impermissible for judges to cross, one

³⁰ At 756, 757 per Lord Wilberforce.

³¹ At 748 per Lord Donovan.

³² At 748 per Lord Donovan.

cannot help but think that Lord Wilberforce's comment to the effect that the limits of judicial interpretation were passed when one attempted to apply s 108 held particular pertinence. The risk of judicial legislation, so far as s 108 was concerned, was in his Lordships' view, a live concern.

C Further Reform

1 A Distinction without a Difference?

Given the tendency on the part of New Zealand's anti-avoidance rules to be made subject to amendment or reform, it was to only be expected that s 108 of the LITA 1954 would itself in time be deposed by the passage of a successor. This came in the form of s 99 of the Income Tax Act 1976 (ITA 1976). This would in time go on to become ss BG 1 and GB 1 of the Income Tax Act 1994 (ITA 1994), the same sections of the Income Tax Act 2004 (ITA 2004), and, ultimately, s BG 1 and s GB 1 of the ITA 2007. It must be remembered, however, that despite their differing titles, the essence of these provisions remained for the most part largely identical, with only a few differences to separate them from one another. That said, however, there were new several features of interest attaching to the introduction of s 99.

2 Enter Section 99

Perhaps most significantly, s 99 did not merely allow the Commissioner to "annihilate" offending arrangements, but also gave him or her additional powers to adjust the income of the taxpayer (in addition to that of any person affected by an arrangement into which the taxpayer had entered). Second, s 99 could also be applied to new, as much as existing, sources of income. Third, and of particular concern, s 99 represented the re-introduction of the word "avoidance." This was defined in such a way as to do away with the *Newton*³³ predication test (which placed any form of dealing that might be said to be of "family" or "business" variety beyond the reproach of the courts). Hence, the mere fact that a transaction or arrangement could be characterised as "ordinary" would no longer render it beyond the reach of the GAAR.³⁴

³³ *Newton v Federal Commissioner of Taxation* [1958] AC 450 (PC).

³⁴ Michael Littlewood "The Privy Council and the Australasian Anti-Avoidance Rules" (2007) 2 BTR. 175 at 197.

D New Zealand's GAAR

1 Section BG 1

(a) Charging Provision

The “charging” provision of New Zealand’s GAAR is s BG 1 of the ITA 2007. This is as follows:

Avoidance arrangement void

- (1) A tax avoidance arrangement is void as against the Commissioner for income tax purposes

Reconstruction

- (2) Under Part G (Avoidance and non-market transactions), the Commissioner may counteract a tax advantage that a person has obtained from or under a tax avoidance arrangement

Under s BG 1 the Commissioner may either treat the arrangement into which the taxpayer has entered into as void, or consider what *would* have happened, but for the arrangement, what *would in all likelihood* have happened, and what *might be expected* to have happened under s GA 1(4).³⁵

(b) Arrangement

Section YA 1 gives the definition of “arrangement.” This is defined as:

...an agreement, contract, plan or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried into effect.

(c) Tax Avoidance

In addition, s YA 1 sets out the definition of ‘tax avoidance’ thus:

- (a) directly or indirectly altering the incidence of any income tax
- (b) directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax
- (c) directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax

³⁵ Michael Littlewood “Tax Avoidance, The Rule of Law and the New Zealand Supreme Court” [2011] NZ L Rev 35 at 41.

(d) Tax Avoidance Arrangement

Section YA 1 states that a “tax avoidance arrangement:”

Means an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly -

- (a) has tax avoidance as its purpose or effect; or
- (b) has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is preferable to ordinary business or family dealings if the purpose or effect is not merely incidental
- (c) Directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax.

2 *Questions of the New Zealand GAAR*

While section BG 1 differs in some respects from the Canadian s 245, it does, however, contain many of the same conceptual problems.³⁶ These are explored below.

(a) What is “Tax Avoidance”?

While s YA 1 purports to present a definition of “tax avoidance,” the one it contains presents a number of shortcomings that raise difficult questions not only for taxpayers, but for all those who encounter it; indeed, so far as definitions are concerned, it is, regrettably, an “outstandingly bad one.”³⁷

For instance, in referring to “altering the incidence of any income tax,” paragraph (a) exhibits a familiar conceptual problem in not differentiating between an accrued and potential liability. If this refers to accrued liability then there are no transactions to which the GAAR could conceivably apply, as liability to tax, once incurred, cannot be displaced. However, if it is instead to be taken as referring to potential liability, then the GAAR must be given to apply to virtually all transactions that alter the potential incidence of tax, an outcome that, obviously, the legislature could not possibly have intended.³⁸ Where paragraph (b) refers to both “liability” and “potential or prospective liability” there is again an information deficit, for there is no insight accompanying the phrase “potential or prospective.”³⁹ Should, for

³⁶ See Nabil Orow “Towards a Conceptually Coherent Theory of Tax Avoidance” Part 1 (1995) 1 NZJTL 288 and Part 2 (1995) 1 NZJTL 307.

³⁷ Littlewood, above n 35, at 41.

³⁸ At 41.

³⁹ At 41.

instance, the section be understood as drawing a distinction between these two terms? How might the quantum or likelihood of a “potential” or “prospective” liability be determined?

Perhaps the greatest offender, however, is paragraph (c), which, in containing a variation upon the very term that it would seek to define, presents a circularity of definition; surely, the word “avoiding” is of limited use in articulating the tenets and parameters of “avoidance?” Pressing on, however, it might be asked what one is meant to make of the use of the term “postpone?” Would not liability, if postponed, not be “avoided” as much as “delayed?” The presence of these questions suggests that the ambit of the definitions presented by s YA 1 remains unclear.⁴⁰

(b) What is an “Arrangement?”

There is little to say about the definition of “arrangement” contained within section YA 1 save that it is so broad as to potentially encompass any and all forms of dealing. Yet as the definition would seem incapable of assisting the reader in discerning what an arrangement is *not*, it is hard to see how it can be said to be capable of explaining what an arrangement *is*. It is therefore questionable as to whether the definition provided by s YA 1 ought to be regarded as any sort of definition of all.

(c) What is an “Avoidance Arrangement?”

A key difference between s BG 1 and its Canadian counterpart lies in its reference to an “avoidance arrangement” rather than the concept of the “tax benefit.” However, as paragraph (a) defines an avoidance arrangement as an arrangement with the “purpose or effect” of tax avoidance (without any caveat in the form of a bona fide purpose exemption, as in Canada) that purpose and effect will be confused is, from the words of the section, more or less a foregone conclusion. Section BG 1, if applied literally, would extend to ensnare every transaction imaginable.

The essence of paragraph (b) is to mandate that the presence of a “family” or “business” purpose will not save an arrangement with the purpose or effect of tax avoidance. The one qualification to this statement is where the tax avoidance purpose is “merely incidental.” The difficulty with the “merely incidental” threshold, however, is that no objective standard has been provided by which its application might be determined. As far as this definition might profess to offer guidance, it would seem to be entirely wanting.

⁴⁰ Readers may also be interested to see James Coleman *Tax Avoidance in New Zealand* (CCH New Zealand Ltd, Auckland, 2009) at 59.

As for paragraph (c), there is little to add save that it is simply not clear what it means in referring to the “postponement” of liability, and why this should be regarded as tax avoidance. This, along with paragraph (a), could likewise be said to extend to all manner of transactions and would seem to possess an unlimited scope.

3 *The Amplification of Ambiguity*

As a result of the difficulties presented by s BG 1, it would appear that the problems inherent in the concept of tax avoidance are not mitigated, but rather added to, amplified and enhanced through the introduction of new terms and an absence of intelligible definitions. Accordingly, it is unlikely that concise and consistent case law could ever result from its application.

E The Arrival of Scheme and Purpose: CIR v Challenge Corporation

While the case of *Mangin* may have been significant for the application of s 108, the case of *CIR v Challenge Corporation (Challenge)*⁴¹ is arguably more so, as it marks the development of the purposive approach to tax avoidance in New Zealand. Additionally, *Challenge* represents the source of the “scheme and purpose” approach, which (depending upon with whom one speaks) may remain in force still.

1 *Challenge: The Facts*

The facts of *Challenge* concerned Challenge Corporation Limited (Challenge), a profitable taxpayer company that purchased from Merbank Limited (in liquidation) the entirety of the issued share capital in Perth Property Consultants Ltd (Perth).⁴² Importantly for Challenge, Perth had made a trading loss approximately equal to its indebtedness to its parent company, Merbank Corporation Ltd. However, upon sale this debt was written off. Consequently, the taxpayer received Perth as the holder of a large deductible loss. Under s 191 of the ITA 1976, this loss was transferred to the other subsidiaries of the taxpayer, resulting in a reduction in the taxpayer’s assessable income. The Commissioner did not take kindly to this arrangement and disallowed the deduction on the grounds that it was caught by s 99 of the ITA 1976. Before the High Court,⁴³ the taxpayer’s appeal was allowed, a decision upheld by a majority of the Court of Appeal (Woodhouse P dissenting).⁴⁴ The Commissioner further appealed to

⁴¹ *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1986] 2 NZLR 513 at 516.

⁴² Readers may be interested to note that Merbank was named and registered by Mr John George Russell, who is perhaps New Zealand’s most famous tax litigant. See Alistair Hodson “Track A to E Alphabet Soup: John Russell’s Still Cooking!” (2011) 6(1) *Journal of the Australasian Tax Teachers Association* 68 at 69.

⁴³ *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513 at 516.

⁴⁴ At 530.

the Privy Council, where a majority led by Lord Templeman (Lord Oliver dissenting) ruled in favour of the Commissioner.⁴⁵

2 *The Decision of the High Court*

Although Barker J regarded the transactions at issue as *prima facie* coming within the purview of s 99, his Honour ultimately reached the view that the taxpayer's reliance upon the specific ss 188 and 191 was not impugned by s 99.⁴⁶ This was as his Honour did not consider that the facts of *Challenge* displayed a choice by the taxpayer so much as a "marshaling of affairs" which complied with the letter of the specific parts of a taxing Act.⁴⁷ The "choice principle"⁴⁸ permitted the taxpayers to order their affairs as to reduce their liability to tax. Consequently, the taxpayer's challenge was allowed.

3 *The Decision of the Court of Appeal*

Richardson J's decision is particularly significant for the formulation of the "scheme and purpose" approach to statutory interpretation. The formulation of the scheme and purpose approach would seem to have sprung chiefly from Richardson J's recognition that to read s 99 literally would produce undesirable and even absurd results. His Honour considered that the legislature could not have meant for s 99 to deprive taxpayers of all incentives, exemptions, and allowances provided for by tax legislation. Taking advantage of incentives provided for by the legislation could not possibly be regarded as acting in contravention of the Act where these were offered.⁴⁹

This analysis led Richardson J to regard s 99 as living in an uneasy compromise with other specific provisions of the income tax legislation. The legal answer would turn on "an overall assessment of the respective roles of the particular provision and s 99 under the Statute and of the relation between them."⁵⁰ In the instant case, his Honour held that the use of s 99 was precluded by the existence of s 191 of the ITA 1976. This, his Honour described as a "complex provision" which had been changed, developed and refined by legislative amendment over a number of years. His Honour concluded that to treat the arrangements which the taxpayers carried out as tax avoidance within s 99(1) would defeat, rather than promote, the legislative purposes involved.

⁴⁵ At 556.

⁴⁶ Although these provisions had been subject to an amendment in 1980, this was of no application to the facts.

⁴⁷ *Challenge*, above n 43, at 529 per Barker J.

⁴⁸ Developed in the Australian High Court case of *W P Keighery Pty Ltd v FCT* 100 CLR 66.

⁴⁹ At 549 per Richardson J.

⁵⁰ At 549 per Richardson J.

Although Cooke J regarded s 99 as having remedied some of the deficiencies contained within s 108 (described as a “rusty instrument” by Lord Wilberforce in *Mangin*), Parliament had noticeably refrained from specifying the relation between s 99 and other provisions in the income tax legislation.⁵¹ This, in Cooke J’s view, was deliberate, and indicated a desire on the part of the Legislature for this to be determined by the courts. His Honour would have applied s 99 on the facts but for the presence of s 191 of the ITA 1976. The presence of a specific anti-avoidance rule inferred the provision was “exhaustive in its own field.”⁵² His Honour therefore ruled that s 99 did not apply to the present arrangement, and in so doing, upheld the decision of the High Court.

Dissenting from the decision of his colleagues was Woodhouse P. While his Honour agreed that, in enacting s 99, Parliament had taken legislative steps to deal with some of the judicial criticisms of s 108, there were two advancements that his Honour declared himself “unable to accept.”⁵³ These were first, that s 191 contained within itself, in the form of s 191(c)(i), the comprehensive answer to tax avoidance for its own purposes to the exclusion of s 99, and second, that by expressly restricting the anti-avoidance operation of paragraph (c)(i) to a temporary association of companies Parliament must be taken to have accepted as valid the tax consequences of any association that was longer. His Honour did not think such an “important gloss” could be read into either s 191 or the “plain language of s 99” especially in the light of the significance of the latter to income tax legislation.⁵⁴

4 *The Decision of the Privy Council*

The decision of the Privy Council resulted in a split decision between the majority, led by Lord Templeman, and the dissenting judgment of Lord Oliver of Aylmerton.

There are two matters of particular significance contained within the judgment of the majority. First, that it endorsed Richardson J’s “scheme and purpose” approach⁵⁵ and second, that it introduced into New Zealand’s tax law a distinction between “tax avoidance” and “tax mitigation.” Tax mitigation was defined by Lord Templeman as when a taxpayer “reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability.”⁵⁶ It was this to which s 99 was said not to apply, but rather to tax avoidance, which was defined as “when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which would entitle him to that reduction.”⁵⁷

⁵¹ At 541 per Cooke J.

⁵² At 543 per Cooke J.

⁵³ At 539 per Woodhouse P.

⁵⁴ At 540 per Woodhouse P.

⁵⁵ Littlewood, above n 34, at 198.

⁵⁶ *Challenge*, above n 43, at 561 per Lord Templeman.

⁵⁷ At 561 per Lord Templeman.

As to the application of s 191 of the Income Tax Act 1976, the majority took the view that Parliament was either unmindful of any overlap between the general provisions of s 99 and the particular provisions of s 191(1)(c)(i), or thought that an overlap between the two might be useful. Their Lordships considered the provisions of s 99 to be of general application and that, in the absence of an express direction of Parliament excluding s 191 from the ambit of s 99, the section was to be applied to the facts. This, their Lordships held, was supported by the legislative history of both s 99 and s 191.⁵⁸

Dissenting from the opinion of the majority, Lord Oliver of Aylmerton held that if s 99 had stood alone, it would have been difficult to imagine a clearer case of a transaction entered into for the purpose of tax avoidance; the provisions of s 191(1)(c)(i), however, prevented his Honour from accepting that view; if the use of s 191 was to be treated as avoidance for the purposes of s 99, then his Lordship regarded s 99 as having the effect of depriving the relevant provisions of s 191 of any operation at all.⁵⁹

5 Questions of Challenge

Understanding the nature of Richardson J's scheme and purpose approach has not proved easy. In this respect, Craig Elliffe, writing in *New Zealand Taxation*,⁶⁰ helpfully pointed to a number of specific propositions that could be extracted from Richardson J's analysis.⁶¹ These were first, that s 99 was not an independent charging provision, and second that s 99 was not a "super provision" with the ability to override specific provisions. Professor Elliffe's third proposition was that s 99 was not subordinate to all of the specific provisions in the ITA, as this would render it a "dead letter." Rather (and fourth), s 99 and the other provisions in the ITA worked together, living in any "uneasy compromise" with one another. Fifth, and finally, Elliffe considered that Richardson J's remark that "each section had its function under the statute" indicated a "dual" or "tandem" approach was to be applied in effort to ensure the achievement of consistent results.⁶²

Richardson J did not consider this approach to be a panacea or "silver bullet" for contending with all the difficulties associated with tax avoidance; consider, for instance, his Honour's remark upon the presence of inconsistencies and structural inequities within the tax base.⁶³

⁵⁸ At 559 per Lord Templeman.

⁵⁹ At 563 per Lord Oliver of Aylmerton.

⁶⁰ Craig Elliffe "Tax Avoidance" in *New Zealand Taxation 2012 Principles, Cases and Questions* (Brookers, Thomson Reuters Wellington, 2012) at 1051.

⁶¹ At 1077.

⁶² At 1077.

⁶³ "There is force in the thesis that in many respects the tax base is so inconsistent and contains too many structural inequities that a single general anti-avoidance provisions such as s 99 cannot be expected to provide

However, a virtue of Richardson J's approach was that it was chiefly grounded in an examination of the text of the statute, rather than of the arrangement itself. Consequently, the application of fiscal legislation was likely more predictable and transparent than it has become in the years since the advent of *Ben Nevis*⁶⁴ and the parliamentary contemplation test.

The emphasis placed by the Privy Council upon the distinction between “tax mitigation” and “tax avoidance” was conceptually problematic not least as it offered no indication as to how the distinction was to be applied. If “tax avoidance” was something that occurred when a taxpayer reduced his liability to tax without involving him in the loss or expenditure that would entitle him to that deduction, then this did not consider whether the taxpayer would in fact be entitled to the deduction in the first place and not caught by a specific provision to the contrary.

F The Case of Commissioner of Inland Revenue v Auckland Harbour Board

The case of *Commissioner of Inland Revenue v Auckland Harbour Board* (Auckland Harbour Board)⁶⁵ is significant not only for its remarks on New Zealand's then anti-avoidance rule, but also as being among the last of New Zealand tax cases to appear before the Privy Council alongside those of *Miller*⁶⁶ and *Peterson*.⁶⁷

1 Auckland Harbour Board: The Facts

In 1988 the, taxpayer, Auckland Harbour Board (AHB), transferred approximately \$20 million of government and local authority stock to two trusts of its own creation for nil consideration. It was accepted that the stock holdings qualified as “financial arrangements” under the accruals regime laid out in s 64B – 64M.⁶⁸ At issue was whether AHB was able to deduct from its assessable income the sum of \$8.6 million. This had been calculated in accordance with a formula contained within s 64F(2) of the ITA 1976, a provision which governed the adjustment of the base price of a financial arrangement. Because of the absence of consideration for the transfer of the stock by AHB, a negative base price adjustment resulted, which represented an allowable deduction under s 64F(4) of the ITA 1976 nonetheless.

an effective measure by which to weigh the exercise of tax preferences.” See *Challenge*, above n 43, at 549 per Richardson J.

⁶⁴ *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC).

⁶⁵ *Commissioner of Inland Revenue v Auckland Harbour Board* [2001] 3 NZLR 289.

⁶⁶ *Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316.

⁶⁷ *Peterson v Commissioner of Inland Revenue* [2006] 3 NZLR 433.

⁶⁸ See ss 64B – 64M of the ITA 1976.

While the Commissioner agreed that AHB was entitled to a deduction under s 64F(4), he argued that s 64J(1) applied, a provision that entitled the Commissioner to reject a deduction where dealing of the parties had the effect of “defeating the intent and application of ss 64B – 64M” of the ITA 1976. Although the High Court⁶⁹ found that the Commissioner was entitled to reject the deduction claimed by the AHB under s 64J(1) of the ITA 1976, this decision was overturned by a majority of the Court of Appeal⁷⁰ which found in favour of the taxpayer. This decision was upheld by the Privy Council.⁷¹

2 *The Decision of the Privy Council*

The Committee regarded the central issue as whether the transfer which AHB chose to make for nil consideration was a dealing which had “the effect of defeating the intent and application” of the accrual regime. In their Lordships’ view, the Commissioner’s argument involved “putting s 64(J) to a very unusual use.” Typically, the circumstances that would justify its application would be specific, “arising out of the relationship between the parties and other relevant transactions, such as s 99.” Although the *Ramsay* approach to the construction of tax statutes had taken over some of the work these provisions used to do, their Lordships did not wish to cast doubt upon “the usefulness of such tax avoidance provisions as a long stop for the Revenue.”⁷²

While the Commissioner had accepted that the transaction had attracted a deduction, he also claimed the right to be able to amend the law to ensure that it did not. Their Lordships did not think that the section “was intended to confer such a power,” and that this “would amount to the imposition of tax by administrative discretion instead of by law.”⁷³ In light of these comments, it should come as little surprise that the Privy Council upheld the reasoning of the majority of the Court of Appeal.

3 *Questions of Auckland Harbour Board*

The Committee’s remark that s 99 of the ITA 1976 represented a “longstop for the Revenue” is notable as it would seem to have insinuated that s 99 existed as a provision of last resort, rather than of initial recourse. Perhaps the Privy Council felt the Commissioner had in this instance overstepped his mark in laying claim to powers that the court did not agree his office afforded him. If so, this would accord with its warning against the imposition of tax by “administrative discretion,” an admonition which carries with it echoes of the work of authors such as Smith, Dicey and Hayek.

⁶⁹ *Auckland Harbour Board v Commissioner of Inland Revenue* (1998) 18 NZTC 13,826.

⁷⁰ *Auckland Harbour Board v Commissioner of Inland Revenue* (1999) 19 NZTC 15,433.

⁷¹ *Auckland Harbour Board*, above n 65.

⁷² At [11] per Lord Hoffmann.

⁷³ At [12] per Lord Hoffmann.

G Miller v Commissioner of Inland Revenue

1 Miller: The Facts

In *Miller & Ors v Commissioner of Inland Revenue (Miller)*, the taxpayers entered into a scheme whereby they sold their shareholding in a trading company to a company controlled by the accountant, leaving the purchase price outstanding and secured by a mortgage over the shares.⁷⁴ The trading companies paid their net profits, half yearly, as a tax deductible administration fee to the purchasing company. The purchasing company utilised tax losses that were available to it as part of a group of companies to offset its liability to tax. The money the taxpayers paid was then returned, as an installment of the purchase price of the shares, less a fee. The essence of the scheme involved the transformation of the entire net profits of the taxpayer's companies into tax-free capital.⁷⁵

The Commissioner argued that the scheme was an arrangement within the meaning of s 99 of the ITA 1976 and assessed the trading companies based on a reconstruction of what would have transpired in the event the scheme had not been entered into (the Track A assessment). However, as a consequence of the trading companies having disposed of their assets, the Commissioner increased the taxpayers assessable incomes (Track B) based on the premise that the taxpayers would have paid themselves the net profits as directors' remuneration. The taxpayers appealed the Commissioner's assessments to the High Court⁷⁶ which dismissed their appeal, a decision upheld by both the Court of Appeal⁷⁷ and the Privy Council.⁷⁸

2 The Decision of the Privy Council

The Committee described the scheme as "highly artificial," and, in light of such a plain case, their Lordships considered it "unnecessary to examine in any depth the criteria by which the arrangements caught by s 99 may be distinguished from those which are not." Instead, their Lordships stated their agreement with the view of Baragwanath J that the distinction between tax mitigation and tax avoidance was "unhelpful," on the grounds that it described a conclusion instead of providing a signpost to it. However, their Lordships doubted the wisdom of enlisting the concept of "impropriety" instead, as this suggested a moral judgment, which was inappropriate.⁷⁹ Whether a course of action which avoided tax would fall within s

⁷⁴ *Miller*, above n 66, at [6] per Lord Hoffmann.

⁷⁵ At [1] per Lord Hoffmann.

⁷⁶ *Miller & Ors v Commissioner of Inland Revenue* (1997) 18 NZTC 13,219.

⁷⁷ *Miller v Commissioner of Inland Revenue* [1999] 1 NZLR 275.

⁷⁸ *Miller*, above n 66

⁷⁹ At [9] per Lord Hoffmann.

99 would depend on whether the legislation “upon its true construction, was intended to give the taxpayer the choice of avoiding it in that way.”⁸⁰

3 *Questions of Miller*

(a) Might a Specific Provision have Sufficed?

Although it is difficult to argue with the result of *Miller*, there is the question of whether the scheme might have been made the subject of specific prohibition. Was it necessary to use s 99? Arrangements that transform profit into tax-free capital are common; accordingly, the use of a specific provision might have not only caught the scheme but also possibly deterred it from arising in the first place, in the process doing considerably less harm to the value of certainty.

(b) The End of Avoidance/Mitigation?

There is also the somewhat awkward matter of the “avoidance/mitigation” dichotomy which the case of *Miller* would seem to have cast aside. Quite what one is to make of this, however, is unclear, particularly as some form of dichotomy to differentiate between conduct which is “orthodox” and that which is “heretical.” In this respect, Shelley Griffiths was, in the writer’s view, correct to regard the dichotomy as the “description of a conclusion,” an analytical tool with a “limited pedigree.”⁸¹ Griffiths also made a connection between Lord Templeman’s fondness for this dichotomy and the arguments over the fiscal nullity doctrine in the UK. This raises the interesting question of the extent to which external judicial conflicts have influenced the development of New Zealand’s tax law. Did, for instance, the controversial nature of the *Ramsay* rule create as many problems for other jurisdictions in the Commonwealth as it did for the UK? Or would these difficulties have arisen in any case due to the inherently problematic nature of tax avoidance? Certainly, this presents pause for thought.

H The Case of Commissioner of Inland Revenue v BNZ Investments Ltd

The next most significant case to have implications for New Zealand’s GAAR was arguably that of *Commissioner of Inland Revenue v BNZ Investments Ltd (BNZ Investments No 1)*.⁸²

⁸⁰ At [10] per Lord Hoffmann.

⁸¹ Shelley Griffiths “‘Tax Mitigation’ – the Reprise?” [2005] NZLJ 27

⁸² *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450 [*BNZ Investments No 1*].

1 *BNZ Investments No 1: The Facts*

In *BNZ Investments No 1*, the Bank of New Zealand (BNZ) borrowed funds that its subsidiary, BNZ Investments (BNZI), used to make a series of Redeemable Preference Share (RPS) investments in companies provided by Capital Markets Ltd (CML). BNZI received a return as dividends from the dates of issue of the RPS until the date of maturity, which was between nine months and three years later. CML placed the funds in offshore interest-bearing deposits. Dividend rates on the RPS were negotiated between BNZ for BNZI and CML from the premise that no allowance was required for New Zealand tax on downstream income, and that the dividends paid on the RPS would be exempt income as intercompany dividends in the hands of BNZI.

The Commissioner claimed that the transaction was caught by s 99 of the ITA 1976. The taxpayer challenged this before the High Court,⁸³ which held in favour of BNZI. The High Court found that the downstream transactions were not part of the arrangements entered into affecting BNZI. The Court of Appeal (Richardson P, Tipping and Keith JJ, Blanchard J concurring, Thomas J dissenting)⁸⁴ found in favour of the taxpayer.

2 *The Decision of the Court of Appeals*

Significant among the issues canvassed by the Court was whether, in regard to BNZI, the “upstream” (issuer and upwards) transactions and the “downstream” (below issuer) transactions were to be treated as one arrangement under s 99. A majority of the Court of Appeal held that the meeting of minds necessary to constitute an arrangement under s 99 was to encompass either explicitly or implicitly the dimension which actually amounted to tax avoidance.⁸⁵ On the facts, the majority found that there had been no meeting of the minds as to what steps or activities would be undertaken downstream, rendering the “upstream” and “downstream” transactions separate and different arrangements for the purposes of s 99.⁸⁶

Dissenting from the opinion of the majority was Thomas J. His Honour described s 99 as the “core bulwark” against tax avoidance, the “central means of protecting the integrity of the tax system” in New Zealand.⁸⁷ The problem in part with the interpretation and application of s 99 was the “unrealistic expectation” of the certainty which it was possible to achieve with a GAAR; while as much certainty as possible was desirable, general anti-avoidance provisions were “necessarily uncertain” if they were to “cover the multiplicity of schemes designed to

⁸³ *BNZ Investments v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732.

⁸⁴ *BNZ Investments No 1*, above n 82.

⁸⁵ At [52] per Richardson P.

⁸⁶ At [56], [57] per Richardson P.

⁸⁷ At [77] per Thomas J.

avoid tax”⁸⁸ Interestingly, his Honour opined that judicially created anti-avoidance doctrines, such as the fiscal nullity doctrine operating in the UK, were also uncertain, possibly even more so than statutory provisions.⁸⁹ On the facts, his Honour did not agree with the finding of the majority that there was a “natural divide”⁹⁰ between the upstream and downstream analysis and regarded the agreement or understanding between the parties as within the scope of the arrangement for the purposes of s 99.⁹¹

3 Questions of *BNZ Investments (No 1)*

As far as the application of s 99 was concerned, *BNZ Investments No 1* served to confirm the application of the scheme and purpose approach outlined in *Challenge*. Although this approach to the GAAR was not without difficulty it was one concerned chiefly with an examination of the language contained within the provisions of the tax legislation itself and was therefore perhaps almost as much as could be hoped for.

A significant source of contention in *BNZ Investments No 1* was the scope of the term “arrangement.” While the majority held that an arrangement involved consensus, a meeting of the minds between parties, “involving an expectation on the part of each that the other will act in a particular way”⁹² Thomas J regarded the emphasis placed by majority on the words “made or entered into” within the section as “conspicuously strained,” arguing that the majority had disregarded the fact that it was the *effect* of the arrangement that was critical.⁹³ Often, disputes as to the proper application of GAARs would seem frequently attributable to the absence of guidance contained within the GAAR itself as to how it is to be applied; in this respect, *BNZ Investments No 1* would seem no exception.

Notable was the majority’s abandonment of the “avoidance/mitigation” distinction advanced in *Challenge* in favour of the alternative categories of “legitimate tax planning” and “improper tax avoidance.” An important question revolves about the extent to which these were simply alternative labels for the same concepts, or whether they rather represented a shift in judicial attitudes; after all, why would the majority use alternative terms if the underlying concepts remained unaltered?

A problem with Thomas J’s remarks on the value of certainty was that these treated the GAAR as if the nature of its target were merely occasionally difficult to discern, rather than

⁸⁸ At [91] per Thomas J.

⁸⁹ At [93] per Thomas J. This is a matter of some interest, and it is unfortunate that his Honour did not elaborate further. This is the subject of further discussion in Chapter Seven.

⁹⁰ At [148] per Thomas J.

⁹¹ At [166] per Thomas J.

⁹² At [50] per Thomas J.

⁹³ At [131], [134] per Thomas J.

habitually indefinable. For instance, his Honour held that in order to be effective, a general anti-avoidance provision could not be precise.⁹⁴ Yet this statement only raises the questions first, of how the effectiveness of a GAAR is to be judged, and second, how the courts can feel confident enough to apply such an “imprecise” instrument. Such issues would seem structural and systemic within GAAR jurisprudence.

I The Case of Peterson v Commissioner of Inland Revenue

Following *BNZ Investments No 1* came the case of *Peterson v Commissioner of Inland Revenue (Peterson)*.⁹⁵ Notably, it was the last tax avoidance case to be heard by the Privy Council.

1 Peterson: The Facts

The appellant taxpayer in *Peterson* was a member of a syndicate of investors that acquired the rights to two films purchased in two separate transactions for a fixed sum. While the cost of the production of the films was expected to reach \$x, the investors were erroneously led to believe that it would cost \$x + y (the value of \$x representing funds obtained from investors in cash, and \$y the proceeds of a non-recourse loan from a third party). The value of \$y was, however, never put to use in the production of the film but was instead “recycled” to the lender immediately after it was received.⁹⁶ This allowed the investors to obtain a tax advantage in the form of a depreciation allowance that reduced their liability to tax. It was the Commissioner’s allegation that the arrangement was caught by s 99.

Although the High Court⁹⁷ had found in favour of the taxpayers, the Court of Appeal⁹⁸ reversed this decision in favour of the Commissioner. In a decision split 3-2 a majority of the Privy Council led by Lord Millett (Baroness Hale of Richmond and Lord Brown of Eaton-under-Heywood concurring, Lord Bingham of Cornhill and Lord Scott of Foscote dissenting) allowed the taxpayers’ appeal.⁹⁹

2 The Majority Judgment

A majority of the Privy Council represented by Lord Millett, Baroness Hale of Richmond and Lord Brown of Eaton-under-Heywood found that the taxpayers had incurred the expenditure in the manner contemplated by Parliament and, accordingly, were entitled to the depreciation

⁹⁴ At [93] per Thomas J.

⁹⁵ *Peterson v Commissioner of Inland Revenue* [2006] 3 NZLR 433.

⁹⁶ *Dunphy and Ors v Commissioner of Inland Revenue* CIV 2009 485 733 at [63].

⁹⁷ *Peterson v Commissioner of Inland Revenue* (CA 12202 19 February 2003).

⁹⁸ *Commissioner of Inland Revenue v Peterson* [2003] 2 NZLR 77.

⁹⁹ *Peterson*, above n 95.

allowance claimed. Lord Millett, writing for the majority, held that s 99 could not be invoked to disallow the deduction as the Commissioner had not shown that the investors had not suffered the economic burden of the expenditure.¹⁰⁰ The mere fact that the production company had made a profit of \$y at the expense of the investors did not detract from the reality that the investors had suffered the economic cost of paying it.¹⁰¹

Also significant among the majority's findings in *Peterson* was the rejection of the view expressed by the majority in *BNZ Investments No 1*, that an "arrangement" within the meaning of s 99 required a consensus or meeting of the minds. On this point, their Lordships respectfully preferred the dissenting judgment of Thomas J.¹⁰²

3 *The Dissent of Lords Bingham and Scott*

The minority of Lord Bingham of Cornhill and Lord Scott of Foscote was far from convinced that the arrangement should be allowed to stand. In the opinion of their Lordships, the arrangements devised were tax avoidance arrangements of a "plainly undesirable kind" which could not be reconciled with the statutory purpose of encouraging investment in the production of films.¹⁰³ To hold that the apparent ignorance of the investors excused them from vulnerability to s 99 would have been, in the view of the minority, to "emasculate the section."¹⁰⁴ A "clearer case" of tax avoidance could "hardly be imagined."¹⁰⁵

4 *Questions of Peterson*

A significant point of contention between the majority and minority was the question of whether the expense had been properly incurred. While the majority appeared content with the fact that the money had left the hands of the investors, the minority argued that, despite the investor's lack of knowledge as to the falsity of the representations made to them, the use to which the money was put had not involved the taxpayers in the loss or expenditure entitling them to that reduction;¹⁰⁶ the courts should not "shut their eyes" to what had happened to the money after it had left the hands of the investors.¹⁰⁷ The minority further argued that to so hold would deprive s 99 of its "proper effect" in relation to such transactions.

¹⁰⁰ At [42] per Lord Millett.

¹⁰¹ At [43] per Lord Millett.

¹⁰² At [34] per Lord Millett.

¹⁰³ At [92] per Lord Bingham of Cornhill and Lord Scott of Foscote.

¹⁰⁴ At [92] per Lord Bingham of Cornhill and Lord Scott of Foscote.

¹⁰⁵ At [96] per Lord Bingham of Cornhill and Lord Scott of Foscote.

¹⁰⁶ At [96] per Lord Bingham of Cornhill and Lord Scott of Foscote.

¹⁰⁷ At [101] per Lord Bingham of Cornhill and Lord Scott of Foscote.

Yet the difficulty with such reasoning lies chiefly in the proposition that the “proper effect” of s 99 was objectively knowable, which is itself rather a dubious suggestion. After all, s 99 provided next to no information or insight into the circumstances to which it should be applied. Judicial disputes on the matter would therefore seem all but inevitable; in this respect, it is worth noting that the Privy Council was split 3-2 as to the proper approach to New Zealand’s then GAAR.

J The Advent of Ben Nevis

As the first tax case to be brought before New Zealand’s Supreme Court, the case of *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue (Ben Nevis)*¹⁰⁸ represents something of a milestone in New Zealand tax jurisprudence. This case marks a change in the judicial attitude towards the problem of tax avoidance and has arguably ushered in an era of greater uncertainty.

1 Ben Nevis: The Facts

In *Ben Nevis*, the Trinity Foundation Charitable Trust (Trinity) granted the investor taxpayers a licence to use land that it owned for a licence premium of \$2 million per plantable hectare. While some fees and an insurance premium were payable at the establishment of the scheme, the payment of a further insurance premium and the licence premium were both deferred until the expiry of a 50 year period after which Douglas Fir trees planted by the syndicate were to be harvested. The taxpayers provided promissory notes for both these liabilities, in respect of which they claimed deductions for the whole amount in their tax returns for the 1997 and 1998 tax years.

The Commissioner denied the taxpayers’ claims on the grounds that the arrangement was caught by the GAAR, s BG 1 of the ITA 1994, and imposed penalties for the taking of an abusive tax position. The High Court¹⁰⁹ found against the taxpayers and upheld the assessments of the Commissioner, a finding affirmed by the Court of Appeal.¹¹⁰ At the Supreme Court,¹¹¹ a 3-2 split decision resulted between the minority comprised of Elias CJ and Anderson J and the majority represented by Tipping, McGrath and Gault JJ.

¹⁰⁸ *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC).

¹⁰⁹ *Accent Management Ltd & Ors v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027.

¹¹⁰ *Accent Management Ltd & Ors v Commissioner of Inland Revenue* (2007) [2007] NZCA 231.

¹¹¹ *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 289.

2 The Decision of the Supreme Court

The majority held that the courts were to apply a “principled approach” which gave “proper overall effect” to language that expressed different legislative policies.¹¹² The enquiry was aimed at distinguishing between “permissible” and “impermissible” tax advantages.¹¹³ To do this required a two-step approach. First, the taxpayer was to satisfy the court that the use made of the specific provision was within its intended scope.¹¹⁴ Second, the Court was to consider the taxpayer’s use of the specific provision viewed in the light of the arrangement as a whole. If it was apparent that the taxpayer had used the specific provisions and altered the incidence of income tax in a way that could not have been within the contemplation of Parliament when it enacted the provision, the arrangement would be a tax avoidance arrangement.¹¹⁵ While the majority held that s BG 1 did not confine the courts as to the matters which might be taken into account,¹¹⁶ it listed as relevant the following six factors:¹¹⁷

- (i) the *manner* in which the arrangement is carried out,
- (ii) the *role* of all relevant parties and the relationship they may have with the taxpayer,
- (iii) the *economic and commercial effect* of documents and transactions,
- (iv) the *duration* of the arrangement,
- (v) the *nature and extent* of the *financial consequences* that it may have for the taxpayers,¹¹⁸ and
- (vi) the *use made of the specific provision in the light of the commercial reality and the economic effect* of that use.¹¹⁹

The ultimate question was whether the arrangement made use of the specific provisions in a manner consistent with Parliament’s purpose, viewed in a “commercially and economically realistic way.”¹²⁰ While taxpayers had the freedom “to structure transactions to their best tax advantage,” they could not do so in a way “proscribed by the general anti-avoidance provision.”¹²¹ Parliament had left the GAAR “deliberately general.” The courts were not to “strive to create greater certainty than Parliament ha[d] chosen to provide.” While there were

¹¹² At [102] per Tipping and McGrath JJ.

¹¹³ At [106] per Tipping and McGrath JJ. (Littlewood regards this as endorsing the choice principle; see Littlewood, above n 35, at 52).

¹¹⁴ At [107] per Tipping and McGrath JJ.

¹¹⁵ At [107] per Tipping and McGrath JJ.

¹¹⁶ At [108] per Tipping and McGrath JJ.

¹¹⁷ These are factors to which emphasis has been added.

¹¹⁸ At [108] per Tipping and McGrath JJ.

¹¹⁹ At [109] per Tipping and McGrath JJ.

¹²⁰ At [108] per Tipping and McGrath JJ.

¹²¹ *Ben Nevis*, above n 111, at [111] per Tipping and McGrath JJ.

“bound to be difficult cases at the margins,” in most cases it would be possible “to decide on which side of the line a particular arrangement f[ell].”¹²²

(a) The Minority Judgment

A significant cause for disagreement between the minority and majority was the majority’s view that that specific statutory allowances under the ITA were in potential conflict with s BG 1 and required reconciliation; on the contrary, the minority opined that both were to be purposively and contextually interpreted.¹²³ The minority gave its approach as follows:¹²⁴

The first question is whether the claimed allowance deduction falls within the meaning of the specific provision purposively construed. If it does not, the Commissioner can disallow the claim and, if of the view that it is itself a tax avoidance arrangement (because or effect is to alter the incidence of tax), can treat it as void under s BG 1. If the claim is within the meaning of the specific tax provision, purposively interpreted, an arrangement on which it is based may nevertheless constitute tax avoidance if it has the purpose or effect of altering the incidence of tax. If, however, the basis of the claim is not, in itself or as part of wider scheme, an arrangement with the purpose or effect of altering the incidence of tax, it is not tax avoidance under s BG 1.

Quite what the minority meant by this, however, remains in the author’s view somewhat obscure. Littlewood, for instance, interpreted the minority judgment to have endorsed the majority’s view as to the application of the GAAR (in that the taxpayers were caught by it), but to have differed in not agreeing that, but for the GAAR, the scheme would have succeeded. This, in Littlewood’s view, implied that something akin to the *Ramsay* principle was part of New Zealand law.¹²⁵ Somewhat similarly, Elliffe and Keating regarded the minority as holding that the Commissioner did not have to rely on the GAAR because the taxpayers were not properly entitled to the deductions under the specific provisions.¹²⁶

The essence of the difference would appear to have been the minority’s opposition to the idea that the taxpayer’s scheme would have operated in the absence of the GAAR. In light of this disagreement, the writer is not entirely sure whether the minority judgment should be regarded as a caveated dissent from, or as a qualified endorsement of, the majority’s position, as the difference between the positions of two “camps” would seem to strike at the very heart of the interpretation of taxing provisions. In this respect, it is troubling that the dispute even arose at all.

¹²² At [112] per Tipping and McGrath JJ.

¹²³ At [102] per Tipping and McGrath JJ.

¹²⁴ At [3] per Elias CJ and Anderson J.

¹²⁵ Littlewood, above n 35, at 60.

¹²⁶ Craig Elliffe and Mark Keating “Tax Avoidance: Still Waiting for Godot?” (2009) 23 NZULR 370 at 372.

3 The Law Following *Ben Nevis*

(a) Statutory interpretation

Opinion is divided as to the implications of *Ben Nevis* for questions of statutory interpretation. Trombitas, for instance, argued that the proper approach remained to examine the words of the statute and to apply the established principles of statutory construction to discern the intent of Parliament.¹²⁷ In Trombitas' view, "to ensure certainty and fairness" in the tax system, the best approach was one "based on respecting the language used by Parliament." Where "imperfect" expressions of Parliament's will existed, these were for the legislature to remedy.¹²⁸ However, Elliffe and Cameron argued that Trombitas' sentiments did not give full purposive interpretation to the GAAR. In giving equal weight to the statutory provisions, the Supreme Court drew a distinction "between the purpose of the GAAR and the purpose of other provisions." This was "a fundamental change" due to the likelihood that the GAAR might "be read down under the Richardson approach."¹²⁹

Elliffe argued that under the scheme and purpose approach, s BG 1 had often been "read down" because it was tasked with the protection of the liability imposed by the language of the ITA. The parliamentary contemplation test, by contrast, placed greater emphasis on the discernment of contrivance or artificiality and the surrounding factual matrix and substance of the arrangement itself.¹³⁰ Keating similarly contended that, in comparing the tax purpose of an arrangement with any "non-market" aspects likely to breach s BG 1, the Supreme Court's approach reduced tax avoidance to a question of "fact and degree."¹³¹ As it is the taxpayer who must demonstrate that the steps he or she took were within the purpose and contemplation of Parliament,¹³² the emphasis placed on the factual matrix of the transaction would seem to present concern for the value of certainty.

Perhaps the most pressing concern arising from *Ben Nevis* is that the new approach risks blurring the line between purposive interpretation and de facto legislation. There would seem to be the very real risk that the courts might increasingly tend towards using s BG 1 to retrospectively correct what they consider to be deficiencies in the legislation.¹³³

¹²⁷ Eugen Trombitas "The Conceptual Approach to Tax Avoidance in the 21st Century: When the Statute Gives But the GAAR Can Take Away" (2009) 15 NZJTL 352 at 360.

¹²⁸ Eugen Trombitas "Statutory Interpretation and Tax Avoidance" (2010) 11(Dec) NZLJ 428.

¹²⁹ Craig Elliffe and Jess Cameron "Judicial Sea Change" (2010) 16 NZLQ 440 at 449.

¹³⁰ Elliffe, above n 60, at 1083.

¹³¹ Mark Keating "In the Beginning was Trinity" in Maples and Sawyer (ed) *Taxation Issues: Existing and Emerging* (The Centre for Commercial and Corporate Law, University of Canterbury, 2011) 135 at 138.

¹³² *Ben Nevis*, above n 111, at [115]. See also s 149A(2) of the Tax Administration Act 1994.

¹³³ This is a role that was expressly rejected by the Privy Council in *Auckland Harbour Board*. See Elliffe, above n 60, at 1091.

(b) Objective Purpose

Also of significance was the majority's affirmation that the term "purpose" was to be understood "objectively," as opposed to subjectively. That it did so remains problematic, for as Littlewood has pointed out, the word "purpose" is generally taken to refer to a state of mind, something which an arrangement, lacking consciousness as it does, simply cannot possess.¹³⁴ Consequently, the concepts of "purpose" and "effect" are confused.

(c) The Creation of New Categories

Ben Nevis also represents the further creation of new categories of acceptable and unacceptable tax conduct. In this respect, the majority of the Supreme Court in *Ben Nevis* sought to distinguish between "permissible" and "impermissible" tax avoidance. While the extent to which this differs substantively from prior innovations is unclear, it is interesting to note that this represents the replacement of stand-alone categories ("mitigation/avoidance") with those which are merely a matter of degree within the same category ("permissible/impermissible"). Does this indicate a more aggressive approach on the part of the courts? Certainly, it would seem possible.

(d) Might a Specific Provision have sufficed

There is the question of whether a specific provision might have been applied in *Ben Nevis* in place of s BG 1. Littlewood made the compelling argument that s DA 1 of ITA might have been applied to the facts of *Ben Nevis* to much the same effect without having to enlist the aid of the GAAR at all.¹³⁵ Section DA 1 states that expenditure is tax deductible if it is incurred in deriving assessable income. In the case of *Ben Nevis*, however, it is questionable as to whether the expenditure was in fact incurred, much less incurred in deriving assessable income. While the majority regarded it as possible that the taxpayer might not ever incur the *real* expenditure, the Commissioner accepted that the expense had been incurred.¹³⁶ Although *Ben Nevis* was now the leading authority on the scope of the GAAR, the same could be said for its influence on the specific section DA 1, which might now have to be interpreted more generously in the taxpayer's favour than it had previously.¹³⁷

¹³⁴ Littlewood, above n 35, at 53.

¹³⁵ At 57.

¹³⁶ At 58.

¹³⁷ At 59.

(e) Artificiality

Also problematic is the reliance the Supreme Court placed on the concept of “artificiality,” a term not used in income tax legislation.¹³⁸ The difficulty with such a term extends beyond the methodology for determining its presence or absence to the nature of the concept itself. What makes an arrangement artificial? In Trombitas’ view, “approaches based on artificiality/contrivance/pretence/distortion” tended to be “subjective approaches based on an instinctive view of the merits of the tax outcomes.”¹³⁹ It was therefore in his view “not a principled way to approach the issue.”¹⁴⁰ At the very least it would seem unfortunate that more was not said on the matter.

(f) Functionality

There is still the problem of “functionality” arising from the use of the GAAR in conjunction with the purposive approach. While the majority held that the GAAR applied to disallow the transaction, this only raises the question of how, given that the arrangement’s “use” of the provisions was outside the will of the legislature, it could ever have been regarded as having tax effect in the first place. Can an arrangement be “functional” for some purposes, but not others? Is the will of the legislature at odds with itself? The approach set down in *Ben Nevis* has unfortunately done nothing to deal with the underlying tension between the purposive approach and the GAAR, and therefore remains highly problematic.

(g) The Role of English Decisions

Also notable was the majority’s finding that English decisions provided “limited direct assistance” due to the absence of a general anti-avoidance provision in UK tax legislation. Accordingly, it urged care in the application of English cases in a New Zealand context.¹⁴¹ What this means for future decisions, however, remains to be seen.

(h) Certainty

Of interest is the majority’s juxtaposition of the plea on the part of the taxpayers for “reasonable certainty” with the finding that the GAAR has been left “deliberately general.”¹⁴² What this means, however, is unclear. If the GAAR was been left “general” then how did the

¹³⁸ Trombitas, above n 127, at 368.

¹³⁹ At 356.

¹⁴⁰ Eugen Trombitas “The Role for a General Anti-Avoidance Rule in GST” 13 NZJTL 396.

¹⁴¹ *Ben Nevis*, above n 111, at [110] per Tipping, McGrath and Gault JJ. See also Elliffe, Keating, above n 126, at 381.

¹⁴² *Ben Nevis*, above n 111, at [111], [112].

Court feel confident in deciding on its application? Should this be taken to indicate that the level of certainty which taxpayers presently endure is “less than reasonable?” These, and other, similar questions remain. Once more, for all that the Court said, it is doubtful whether taxpayers were rendered any the wiser.

K BNZ Investments Ltd v Commissioner of Inland Revenue

Three significant cases that followed in the wake of *Ben Nevis* were *BNZ Investments Limited v Commissioner of Inland Revenue*, (*BNZ Investments No 2*),¹⁴³ *Westpac Banking Corporation v Commissioner of Inland Revenue*,¹⁴⁴ and *Penny v Commissioner of Inland Revenue*.¹⁴⁵ These cases illustrate the difficulties that confront the courts in the post *Ben Nevis* era of tax avoidance.

1 BNZ Investments No 2: The Facts

The case of *BNZ Investments No 2* involved a series of similar structured finance transactions entered into by the BNZ.¹⁴⁶ The transactions were described as “repo” deals whereby the BNZ made an equity investment in an overseas entity on terms that required the overseas company to repurchase that investment when the transaction terminated. The transactions themselves were structured in such a way as to allow the BNZ to deduct the expenses of earning the income yielded by its investment while receiving that income free of tax.¹⁴⁷ The Commissioner alleged the transactions were caught by s BG 1 of the ITA 1994.¹⁴⁸ The BNZ appealed the Commissioner’s assessments to the High Court, where Wild J held that the transactions were caught by s BG 1.¹⁴⁹

2 The Decision of the High Court

Wild J agreed with the Commissioner that *Ben Nevis* was authority for several important propositions. His Honour regarded the approach adopted in *Ben Nevis* as first, having spelt an end to the “mitigation/avoidance” drawn by the Privy Council in *Challenge*, and second, that *Ben Nevis* had stumped the view put forward by the Privy Council’s in *CIR v Auckland*

¹⁴³ *BNZ Investments v Commissioner of Inland Revenue* CIV 2008-485-1056; (2010) 24 NZTC 23,997 [*BNZ Investments No 2*].

¹⁴⁴ *Westpac Banking Corporation v Commissioner of Inland Revenue* CIV 2005-404-2843; (2009) 24 NZTC 23,834.

¹⁴⁵ *Penny v Commissioner of Inland Revenue* [2012] 1 NZLR 433.

¹⁴⁶ *BNZ Investments No 2*, above n 143, at [1] per Wild J.

¹⁴⁷ At [5] per Wild J.

¹⁴⁸ At [2] per Wild J.

¹⁴⁹ At [16] per Wild J.

*Harbour Board*¹⁵⁰ that s BG 1 was merely a “longstop for the Revenue.” Third, his Honour held that the *Ben Nevis* approach had ended the “threshold” approach,¹⁵¹ and fourth, had endorsed the treating the presence of “artifice” or “pretence” within an arrangement as “highly relevant” in deciding whether that arrangement had a purpose of tax avoidance.¹⁵²

Wild J regarded the approach set out in *Ben Nevis* as requiring the Court, to at step one, undertake a “discrete inquiry,” in order to determine whether the taxpayer had complied with the specific provisions “standing alone,” rather than in the context of the legislative scheme as a whole.¹⁵³ If compliance was not conceded, the Court was to analyse the transaction and decide whether it complied with the applicable specific provisions. However, this analysis was to be a “black letter” one, without “judicial glosses and elaborations.”¹⁵⁴ If answer to the first step was “yes” the court was then to inquire whether the taxpayer’s use of the specific provision, viewed in the light of the arrangement as a whole, was within Parliament’s contemplation and purpose when the specific provision was enacted. Step two, his Honour held, shifted the focus of the inquiry to a “purposive interpretation” of the specific provisions “in the context of the legislative scheme as a whole.”¹⁵⁵

3 Questions of *BNZ Investments No. 2*

(a) Statutory Interpretation

Wild J’s approach presents problems for statutory interpretation. The difficulty with his Honour’s interpretation of the two step approach is that it suggests that the purposive approach is of something less than universal application, an insinuation which has not been well received by commentators. Trombitas, for instance, challenged Wild J’s description of one element of the approach as “black letter” because, under normal principles of statutory interpretation, it would be difficult to conceive that a court would be permitted to interpret a section in isolation from the context of the statute as a whole.¹⁵⁶

¹⁵⁰ *Auckland Harbour Board*, above n 65.

¹⁵¹ This doctrine, favoured by Richardson J in *Challenge* had held that literal compliance with specific provisions could not consistently be treated as tax avoidance. See *Challenge*, above n 43.

¹⁵² *BNZ Investments No 2*, above n 143, at [116] per Wild J.

¹⁵³ At [122] per Wild J.

¹⁵⁴ At [122] per Wild J.

¹⁵⁵ Wild J described this as a “scheme and purpose approach” which required the court to focus on “wider considerations,” including s BG1. At [125] per Wild J.

¹⁵⁶ Trombitas, above n 127, at 378.

(b) Artificiality

Wild's reliance on the concepts of "artificiality" and "contrivance" presents difficulties. The proposition that the presence of these elements is "highly relevant" is contentious because at no stage have the courts ever articulated the nature of these concepts, or the standard by which they are to be measured. Accordingly, there is the risk that the Commissioner may enlist these to describe any scenario or arrangement which he or she views with disfavour. The absence of direction on the part of the courts in regards to these concepts is therefore a significant cause for regret.

L The case of Westpac Banking Corporation v Commissioner of Inland Revenue

1 Westpac: The Facts

The case of *Westpac Banking Corporation v Commissioner of Inland Revenue (Westpac)*¹⁵⁷ involved a number of cross-border structured finance transactions between US and UK counterparties, one of which had been the subject of a favourable binding ruling from Inland Revenue. Despite Westpac's technical compliance with the requirements of the legislation, Inland Revenue successfully challenged the other transactions under s BG 1 of the ITA 1994.¹⁵⁸

2 The Decision of the High Court

Harrison J regarded *Ben Nevis* as a "diplomatic rejection" of Richardson J's approach and an endorsement of the dissenting judgment of Woodhouse P in *Challenge*.¹⁵⁹ *Ben Nevis*, his Honour held, marked two clear points of departure from Richardson J's approach; first a withdrawal from Richardson J's emphasis on specific provisions (this Harrison J regarded as having had the effect of "reading down" or "negating" the reach of the general anti-avoidance section), and second, a move away from a "formalistic" or "juristic" approach that excluded an examination of the circumstances in which the deductible loss arose.¹⁶⁰ His Honour regarded *Ben Nevis* "as prescribing a combined form and substance test." While this did not allow a court "to bypass legal structures" it also meant the legal structure could not "shield a transaction from substantive scrutiny" where the GAAR was invoked.¹⁶¹

¹⁵⁷ *Westpac*, above n 144.

¹⁵⁸ Trombitas, above n 127, at 381.

¹⁵⁹ *Westpac*, above n 144, at [176] per Harrison J.

¹⁶⁰ At [176] per Harrison J.

¹⁶¹ At [195], [196] per Harrison J.

3 Questions of *Westpac*

(a) Statutory Interpretation

Trombitas contended that Harrison J had expanded the approach laid out in *Ben Nevis* into a subjective test rather than adhering to the more traditional approach to ascertaining Parliament's intention with regard to the precise terms of the legislation.¹⁶² In Trombitas' view, "significant reliance" had been placed on the concept of contrivance without proof of "a contrary legislative policy" contained within the text of the statute "beyond the mere assertion that the transaction produced benefits of such a scale that it would not have been Parliament's contemplation or intention to allow these benefits."¹⁶³ Julie Cassidy similarly considered that the concepts of "artificiality" and "pretense" could be criticised on the grounds that these represented the very "[j]udicial glosses and elaborations" that the Supreme Court had warned against.¹⁶⁴

The problem is that in declaring that an arrangement is beyond the pale of parliamentary contemplation the courts would seem merely to be launching ad hominem attacks aimed at the factual matrix of transactions themselves rather than demonstrating their mistaken reliance on specific provisions. It is unlikely that this will prove conducive to the development of principled legal precedent or the promotion of certainty within the tax law.

(b) Treatment of Prior Authorities

Following *Westpac* Littlewood suggested that the application of the *Ben Nevis* approach represented the implied overrule of *Peterson*,¹⁶⁵ the second *Europa* case¹⁶⁶ and *BNZ Investments No 1*¹⁶⁷ (or their having been "confined to their facts").¹⁶⁸ Littlewood's reasoning is almost certainly correct. Owing to the shift in judicial approach since *Ben Nevis*, it is unlikely that such cases will retain much by way of value as precedent and in time will likely come to be regarded as of interest for historical reasons only.

¹⁶² Trombitas, above n 127, at 383.

¹⁶³ At 384.

¹⁶⁴ Julie Cassidy "The Duke of Westminster Should Be 'Very Careful When He Crosses the Road' in New Zealand: The Role of the New Zealand Anti-Avoidance Rule" [2012] NZ L Rev at 30.

¹⁶⁵ *Peterson*, above n 95.

¹⁶⁶ As Littlewood notes, *Inland Revenue Commissioner v Europa Oil (NZ) Ltd* [1971] AC 760 (PC) is often referred to as the first *Europa* case, while *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue* [1976] 1 NZLR 546 (PC) is generally termed the second *Europa* case. See above n 35, at 38.

¹⁶⁷ *BNZ Investments No 1*, above n 82.

¹⁶⁸ Littlewood, above n 35, at 54.

M The Case of Penny and Hooper

1 Penny and Hooper: The Facts

The case of *Penny v Commissioner of Inland Revenue (Penny and Hooper)* concerned two taxpayers who had each set up a company through which to conduct his surgical practices. Each taxpayer was a salaried employee and the sole director of his company, the shares of which were held by his family trust. The taxpayers each drew salaries of between \$100,000 and \$120,000. As of 1 April 2000, the minimum personal tax rate was increased from 33 to 39 cents in the dollar. From this point, each taxpayer received remuneration from his company that was below the level that he had earned when he had conducted the practice in his own name.¹⁶⁹ This allowed the taxpayers to make total savings of between \$20,000 and 30,000 for each year the arrangement was in operation.¹⁷⁰

The Commissioner made assessments increasing the taxable incomes of Mr Penny and Mr Hooper under s BG 1 of the ITA 1994 by an amount equal to the difference between the salaries paid to each taxpayer and what the Commissioner regarded as a commercially realistic salary for their services.¹⁷¹ While the taxpayers succeeded in their appeal to the High Court,¹⁷² the Court of Appeal¹⁷³ overturned this decision (Ellen France J dissenting) and found in favour of the Commissioner, a decision which was upheld by the Supreme Court.¹⁷⁴

2 The Decision of the High Court

The judgment of the High Court was delivered in March 2009; seven months before *Westpac*, and four months prior to *BNZ Investments*. MacKenzie J found for the taxpayer, and significantly, took *Ben Nevis* to have endorsed, rather than departed from, the “scheme and purpose” approach outlined in *Challenge*.¹⁷⁵ The initial reaction to the judgment itself was mixed, as while most commentators would seem to have expected a result broadly in keeping

¹⁶⁹ In the case of Mr Penny, however, the company/trust structure had been established several years before the increase in the minimum individual tax rate, when he would have obtained no tax advantage from the use of the structure. *Penny v Commissioner of Inland Revenue* [2011] NZSC 95 at [2], [3].

¹⁷⁰ The judgment of Randerson J found that the total approximate tax savings were \$65,000 in the case of Mr Hooper, and \$103,000 in the case of Mr Penny. Though these figures differed slightly from these referred to in MacKenzie J’s judgment, Randerson J did not consider the difference to be material. *Commissioner of Inland Revenue v Penny* [2010] 3 NLR 360 at [43] per Randerson J.

¹⁷¹ *Penny*, above n 169, at [5] per Blanchard J

¹⁷² *Penny v Commissioner of Inland Revenue* [2009] 3 NZLR 523.

¹⁷³ *Commissioner of Inland Revenue v Penny* [2010] 3 NLR 360.

¹⁷⁴ *Penny*, above n 145.

¹⁷⁵ “The essence of the Supreme Court’s decision is to endorse a ‘scheme and purpose’ approach.” *Penny*, above n 172, at [19] per MacKenzie J.

with the outcome, the value of the decision itself remained questionable in light of the likelihood of Inland Revenue making an appeal.

3 The Decision of the Court of Appeal

At the Court of Appeal, Randerson and Hammond JJ regarded the claim that the High Court had failed to address the Commissioner's contention that the arrangement was contrived and artificial¹⁷⁶ (a charge which their Honours supported) as of central importance. The salaries were "far removed from commercial reality" and "could not be regarded in any sense as within the acceptable limits of commercial practice."¹⁷⁷ However, while Randerson J endorsed the scheme and purpose approach, his Honour also emphasised the importance of an enquiry into whether the taxpayer's use of the provisions was consistent with Parliament's purpose through an "objective analysis" of the overall scheme and purpose of the Act.¹⁷⁸

Dissenting from the opinion of the majority, Ellen France J expressed the view that neither the formation of the companies and resultant change in the incidence of tax nor the salary arrangements were inconsistent with the scheme and purpose of the Income Tax Act 1994.¹⁷⁹ Her Honour also disagreed with Randerson J's finding of contrivance, concluding that the quantum of the salaries and the taxpayer's control over them were not such as to amount to these.¹⁸⁰

4 The Decision of the Supreme Court

On appeal, the Supreme Court affirmed the decision of the majority of the Court of Appeal, and found in favour of Inland Revenue. Blanchard J, writing for the Supreme Court, affirmed that s BG 1 of the ITA 1994 could apply to arrangements that represented strict compliance with the specific provisions of the Act where these were not within the contemplation of Parliament. His Honour reiterated that such advantages must be within the contemplation of the legislature.¹⁸¹

¹⁷⁶ *Penny*, above n 173, at [6] per Randerson J.

¹⁷⁷ At [122] per Randerson J

¹⁷⁸ At [63] per Randerson J. Above, n 60 at 1094.

¹⁷⁹ At [165] per France J.

¹⁸⁰ At [173], [174] per France J.

¹⁸¹ *Penny*, above n 145, at [47] per Blanchard J. See also *Alesco New Zealand Ltd v Commissioner of Inland Revenue* [2012] 2 NZLR 252 at [89] per Heath J.

5 Questions of Penny and Hooper

(a) What is an Arrangement?

That the use of a relatively innocuous trust and company structure could serve as “arrangement” capable of being caught by s BG 1 is a matter of some importance, particularly as similar arrangements exist among small businesses in New Zealand. Admittedly, while many of these may not mirror the structure at issue in *Penny and Hooper* exactly or involve the same sums of money, there is the risk that the decision of the Supreme Court may serve to embolden Inland Revenue to the extent that other, more common business arrangements increasingly fall subject to scrutiny, creating greater uncertainty in the process.

(b) Artificiality

Noteworthy is the significance the courts attached to the presence of contrivance or artificiality, resulting in no small amount of disagreement among the jurists as whether the arrangement could be so characterised. Troublingly, there would seem to have been a tendency on the part of the jurists who heard the case to reach different conclusions, notwithstanding the profession on the part of each that he or she had applied the same approach. This does not bode particularly well for the principled and consistent application of the parliamentary contemplation test. After all, if New Zealand’s cleverest legal minds were at odds as to the proper characterisation of the “arrangement” at issue, then what hope has the taxpayer of finding his or her way through the post *Ben Nevis* legal maze?

(c) The Corporate Form

It is notable that the judges differed in their view of to whom the income generated by the company as a result of the surgeons’ efforts belonged. While France J regarded the income as the property of the company, Randerson J would seem to have viewed the matter differently.¹⁸² The judgment of Blanchard J left the matter open, holding that *Hadlee’s* case had application, “at least by way of analogy.” It would, his Honour held, “be strange if someone were not for tax purposes permitted to assign income of this kind but could still construct artificially a means of obtaining the same effect for a purpose of altering the incidence of taxation.”¹⁸³ Whether this carries implications for the use of the corporate form is unknown.

¹⁸² *Penny*, above n 174, at [23], [27] per Blanchard J.

¹⁸³ At [50] per Blanchard J.

(d) The Relevance of English Decisions

It is significant that the Supreme Court adopted the Privy Council decision of *Peate v Commissioner of Taxation of the Commonwealth of Australia*.¹⁸⁴ The treatment which pre-*Ben Nevis* case law had received in both the High Court and the Court of Appeal caused Littlewood to wonder at the extent to which cases could still be regarded as authoritative.¹⁸⁵ However, Littlewood argued that since *Peate* had not been expressly (or impliedly) overruled by either the Privy Council or the Supreme Court, the Court of Appeal had been bound by *Peate* and its decision was therefore correct.¹⁸⁶ While Littlewood has a point it is worth recalling that the Supreme Court in *Ben Nevis* had stated that it regarded English decisions as of “limited direct assistance.”¹⁸⁷ In this respect, perhaps the factual similarities between the cases of *Peate* and *Penny and Hooper* commended the case of *Peate* to the Supreme Court. Whatever the reason, it would seem the influence of English authority persists still.

N The case of White v Commissioner of Inland Revenue

1 White: The Facts

The judgment in *White v Commissioner of Inland Revenue (White)*¹⁸⁸ was delivered in October 2010. The facts of *White* concerned an anaesthetist (Dr White) who incorporated a company, Wharfedale Ltd (Wharfedale), for the purpose both of acting as her employer and for leasing two avocado orchards. From November 2002, the entirety of Dr White’s income from private practice was paid to Wharfedale, against which losses arising from the running of the orchards during the 2003 and 2004 tax years were offset. Dr White received no salary from Wharfedale during this period and, as a consequence, paid no personal income tax for the five months to 31 March 2003 and for the year ended 31 March 2004. The Commissioner’s allegation (upheld at first instance by the Taxation Review Authority¹⁸⁹) was that this was a “tax avoidance arrangement” under s BG 1 of the ITA 1994.¹⁹⁰ On appeal to the High Court, however, this decision was overturned, and judgment entered on behalf of the taxpayer instead.

¹⁸⁴ *Peate v Commissioner of Taxation of the Commonwealth of Australia* [1967] 1 AC 308 (PC). Readers may be interested to note this was a case to which the attention of the court had been drawn by a case note penned by Michael Littlewood.

¹⁸⁵ Michael Littlewood “*Penny and Hooper* and Stare Decisis” [2010] NZLJ 404.

¹⁸⁶ Michael Littlewood “*Penny and Hooper*: further thoughts” [2011] NZLJ 6.

¹⁸⁷ *Ben Nevis*, above n 174, at [110] per Tipping, McGrath and Gault JJ.

¹⁸⁸ *White v Commissioner of Inland Revenue* (HC) (2010) 24 NZTC 24,600.

¹⁸⁹ *Case Z 24* (2010) 24 NZTC 14,354 (NZ TRA).

¹⁹⁰ *White*, above n 188, at [2], [8] per Heath J.

2 *The Decision of the High Court*

In Heath J's view, while the effect of the arrangement had been to negate the need for the taxpayer to pay income tax, the purpose of the arrangement was not to avoid tax. However, even if that conclusion were wrong, his Honour regarded the "merely incidental" threshold as having application.¹⁹¹ Although Heath J noted that the term "purpose or effect" was not to be equated with motive,¹⁹² it is possible that Honour's approach was somewhat influenced by a consideration of the subjective motivations of the taxpayer nonetheless. This conclusion is suggested by his Honour's statement to the effect that the fact that the company "happened to make a loss should not turn an otherwise acceptable business arrangement into one characterised as artificial or a contrivance." Although the Commissioner lodged an appeal against the decision of the High Court, it later chose to withdraw this; why the Commissioner did so, however, is not entirely clear.

3 *Questions of White*

(a) Why Did Inland Revenue withdraw its Appeal?

Given Heath J's grounds for finding that the arrangement into which the taxpayer had entered did not constitute tax avoidance, it was surprising that the Revenue chose not to appeal the decision. The difficulty presented by Heath J's reasoning is that it would seem to have treated taxpayer's subjective purpose in entering into the arrangement almost as determinative, when, under the approach laid down by Lord Denning in *Newton* (affirmed by the majority in *Ben Nevis*),¹⁹³ the question of the purpose of the arrangement is to be approached "objectively."

White may therefore illustrate the limitations of New Zealand's test for tax avoidance; had the orthodox approach been applied the inequitable imposition of liability might have resulted. Perhaps this was why Inland Revenue, although initially seeking to appeal, later withdrew from doing so. PricewaterhouseCoopers (PWC) welcomed the decision, stating that it regarded *White* as providing some guidance as to the limits of decision of the Court of Appeal in *Penny and Hooper* (at the time, however, the taxpayers in *Penny and Hooper* had just been given leave to appeal to the Supreme Court).¹⁹⁴

¹⁹¹ At [75] per Heath J.

¹⁹² At [51] per Heath J.

¹⁹³ Littlewood, above n 35, at 53.

¹⁹⁴ PWC "High Court Rules for Taxpayer in Avoidance Case" (26 Oct 2010) Tax Tips <www.pwc.co.nz>.

(b) Rearrangements

It is possible that had *White* upheld it would have essentially rendered rearrangements impossible; the only arrangement that the taxpayer could effect would be the one into which he or she entered at inception. To modify or change this would have been beyond the pale of acceptable behaviour. What would this mean for a sole trader who subsequently enters into partnership with another taxpayer? This would seem to display a tension between the two competing policy goals first, that company law should be as free and uninhibited as possible, and second, that the extent to which a taxpayer may order his or her affairs should be subject to some limitations.

(c) What does it mean?

It is doubtful whether, following the decision of the Supreme Court in *Penny and Hooper*, *White* holds much value for taxpayers. While it might be given to indicate that the courts may take a sympathetic approach to arrangements which improve the taxpayer's position as a consequence of an unanticipated financial loss, there is also the risk (especially given Heath J's approach) that it will come to represent an outlier among authorities, incapable of being relied on in all but the most extraordinary circumstances.

O Alesco New Zealand Ltd v Commissioner of Inland Revenue

In contrast to the outcome in *White*, the case of *Alesco New Zealand Ltd v Commissioner of Inland Revenue* (*Alesco*)¹⁹⁵ represented a significant win for the Commissioner.

1 Alesco: The Facts

The case of *Alesco* involved *Alesco NZ*, a wholly owned New Zealand subsidiary of the Australian *Alesco Corporation Ltd*. At issue were amortised interest deductions claimed by *Alesco NZ* arising from the use of optional convertible notes (OCN), which formed part of intra-group arrangements used to finance the acquisition of businesses operated by New Zealand based companies.¹⁹⁶ The Commissioner argued that both the interest deductions claimed and the loss offset elections made by *Alesco NZ* and its subsidiaries should be disallowed¹⁹⁷ on the grounds that the OCNs lacked “commerciality” and reflected “artificiality, contrivance and pretense” under s BG 1 and GB 1 of the ITA 1994.¹⁹⁸ *Alesco NZ*, however, contended these should stand as it had “complied to the letter” with the

¹⁹⁵ *Alesco New Zealand Ltd and Ors v Commissioner of Inland Revenue* [2012] 2 NZLR 252.

¹⁹⁶ At [3] per Heath J.

¹⁹⁷ At [4] per Heath J.

¹⁹⁸ At [40] per Heath J.

financial arrangement rules and the methodology for calculating a notional interest component of the OCN at the time mandated by Determination G22 (issued by the New Zealand Revenue).¹⁹⁹

Alesco NZ took issue with the Commissioner's method of reconstruction under s GB 1, arguing that it had not taken account of the next best alternative to the OCN funding structure, which it contended was the provision of a loan at market rates between Alesco Corporation and Alesco NZ. Accordingly, Alesco NZ argued that there was no "tax advantage" to counteract as, in the event that this alternative method had been chosen, Alesco NZ might have legitimately claimed greater deductions.²⁰⁰ The High Court,²⁰¹ however, found in favour of the Commissioner, a decision upheld by the Court of Appeal.²⁰²

2 *The Decision of the High Court*

In dealing with s BG 1, Heath J gave careful attention to the approach of the Supreme Court in *Ben Nevis* and *Penny and Hooper*. His Honour noted that in the latter, the Supreme Court had made it clear that tax avoidance could be found in an individual step in a broader arrangement, despite "entirely lawful and unremarkable" structures having been used to comply with specific tax provisions in a manner not within the contemplation of parliament.²⁰³

While Heath J restated the principle that taxpayers were entitled to limit their burden to tax, his Honour ultimately did not regard the advantage that the taxpayer had secured as having come within the contemplation of parliament. His Honour viewed there as having been an absence of any match between expense incurred and income to be returned. Hence, the arrangement was an "artificial device" designed to secure a tax advantage that could not otherwise have been obtained. No real interest expense had been incurred, and the notional interest claimed "did not represent a real economic cost."²⁰⁴ His Honour also held that the Commissioner's assessments in respect of the counterfactual were to stand.²⁰⁵

¹⁹⁹ At [41] per Heath J. Alesco NZ also contended that the Commissioner was wrong not to take account of the next best alternative to the OCN funding structure, which, had it been chosen, would have allowed Alesco NZ to legitimately claim greater deductions. See [46] per Heath J, and also Connelly and Whittington, below n 210.

²⁰⁰ At [57] per Heath J.

²⁰¹ *Alesco*, above n 195.

²⁰² *Alesco and Ors v Commissioner of Inland Revenue* [2013] NZCA 40

²⁰³ *Alesco*, above n 195, at [88] per Heath J.

²⁰⁴ At [147] per Heath J

²⁰⁵ At [160] per Heath J.

3 *The Decision of the Court of Appeal*

The Court of Appeal upheld the decision of the High Court, ruling in favour of the Commissioner. The question in the Court's view was whether the taxpayer had truly incurred the cost as intended by parliament.²⁰⁶ Determination G22 was in the Court's view to be understood in this light. The argument advanced on behalf of Alesco, that Determination G22 transformed the fiscal effect of the absence of an obligation to pay interest into a real economic cost, was dismissed by the court as a "pretence."²⁰⁷

Concerning the counterfactual it was said that the Commissioner was not obliged to adjust the transaction by having regard to the tax effect of what was said to be the most likely counterfactual transaction (in this case, interest bearing debt which would have allowed for the same result by other means).²⁰⁸ A reconstruction based upon the adoption of the taxpayer's hypothetical would have failed to counteract the advantage obtained by Alesco NZ's use of the OCNs, and allowed the company "to secure an increased tax advantage in the form of greater deductions and allocation of more tax losses to its subsidiaries." This, the Court said, would be "perverse."²⁰⁹

4 *Questions of Alesco*

Although in one sense it is difficult to argue with the result (particularly in light of the absence of real interest expense incurred), there are nonetheless several remarks worth making in respect of the possible implications that the case may have for the value of certainty.

(a) Reliance on Specific Advice

To what extent may taxpayers rely on advice issued by the Revenue? As Shaun Connelly and Stephen Whittington wrote shortly after the High Court decision in *Alesco* was delivered, changes in the approach of Inland Revenue and the courts could have the result that "transactions that may be regarded as offering 'permissible' tax advantages at the time they are entered into can, some years later, be subject to Inland Revenue challenge."²¹⁰ Thus, changes in the Revenue's policy may mean the taxpayer finds him or herself grappling with

²⁰⁶ *Alesco*, above n 202, at [71] per Harrison J.

²⁰⁷ At [82] per Harrison J.

²⁰⁸ At [126] Harrison J.

²⁰⁹ At [128] per Harrison J. See also PWC, "Court of Appeal finds for the Commissioner in *Alesco* decision" (7 March 2013) 2 Tax Tips Special" <www.pwc.co.nz> The writer is indebted to Eugen Trombitas, Riaan Geldenhuys and Siew Mei Ou Yang for the valuable insights contain within that article.

²¹⁰ Shaun Connelly and Stephen Whittington "The shifting sands of permissible tax advantages" (10 February 2012) 177 NZ Lawyer Online <www.nzlawyer magazine.co.nz>.

liability for an arrangement that was considered within the bounds of good practice when it was set up. The ground of permissible tax planning can, in other words, move beneath the taxpayer's feet.

(b) Whither the Counterfactual?

Mark Keating found Heath J's approach toward the reconstruction of the arrangement into which the taxpayer had entered to be problematic, noting that while his Honour had not accepted the taxpayer's proposed hypothetical alternative, his Honour had neither offered a better one of his own. In Keating's view, the court had reconstructed the arrangement "on the basis the funds were simply advanced interest free."²¹¹ This was questionable, first, because there was no evidence that the parties had ever considered providing finance on this basis, and second, because it was doubtful that an interest-free loan was even "a permissible alternative as inter-group financing" on the grounds that it risked constituting transfer pricing in breach of ss GC 6 to GC 14 of the ITA 2007 "Accordingly," he concluded, "this reconstruction does not appear to conform to the requirement in s GA 1(4) that the reconstruction should impose the proper tax position the taxpayer would have or would likely have had if the arrangement had not occurred."²¹²

The judgment of the Court of Appeal did little to help matters, as its reasoning would suggest that the Commissioner may counteract an arrangement purely on the basis that he or she does not approve of the outcome rather than as a consequence of any objectionable element contained within the transaction itself. Moreover, the question of how the Commissioner determined the size of the "tax advantage" remained seemingly unanswered; some form of counterfactual is, after all, unavoidable as far as tax avoidance is concerned.²¹³

(d) Certainty

Concerns as to the implications of *Alesco* for certainty remain. Ernst & Young senior tax partner Jo Doolan described the decision of the Court of Appeal as an "alarming result" and as reinforcing the feeling of many investing corporations that the NZ tax environment was "too uncertain."²¹⁴ *Alesco* arguably represents an increasingly aggressive approach on the part of Inland Revenue; *White*, in other words, may not provide guidance for much longer.

²¹¹ Mark Keating "Reconstruction of Tax Avoidance Arrangements: How Best to Rewrite History" (2011) 17 NZJTL 480 at 582.

²¹² At 582.

²¹³ Comparisons may here be drawn with the approach taken by the Commissioner in the Canadian case of *McNichol v The Queen*.

²¹⁴ Hamish Fletcher "IRD has 'slam-dunk' win in landmark tax case" (5 March 2013) New Zealand Herald <www.nzherald.co.nz>.

P INS0121: Tax Avoidance Draft Interpretation Statement

1 Introduction

On 16 December 2011, Inland Revenue released its Draft Interpretation Statement (IS) on tax avoidance, entitled “Tax Avoidance and the Interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007.”²¹⁵ While the Draft Interpretation Statement runs to 117 pages, unlike the 1990 statement on s 99 of the ITA, it contains no examples to illustrate the approach of the Revenue.²¹⁶ Among those who made submissions on the usefulness of the IS were the New Zealand Institute of Chartered Accountants (NZICA), the New Zealand Law Society (NZLS), and accounting firm KPMG, amongst others. Some of the recurring themes are presented below.

2 Themes

(a) Certainty

On the subject of certainty, Andrew Maples and Adrian Sawyer contended that the Draft Interpretation Statement had the potential to cause taxpayers to act more conservatively. Taxpayers seeking to eliminate the risk that an arrangement might be challenged might have no choice but to seek a binding ruling on the transaction from the Revenue.²¹⁷ While Maples and Sawyer regarded the Revenue’s statement as a “small step in the right direction,” in their view, it did little to provide certainty or practical insights into the application of the Commissioner’s approach to ascertaining tax avoidance.²¹⁸ In a similar vein, KPMG did not accept the view put forward in the IS that greater certainty may not be a desirable outcome, arguing instead that this would be inconsistent with the rule of law and economic considerations.²¹⁹

NZICA also extolled the virtue of certainty, focusing on the difficult nature of the relationship between s BG 1 and the rest of the provisions of the Income Tax Act; of all the difficulties raised by Lord Wilberforce in *Mangin*, this, in its view, had yet to be addressed. While the IS accepted that it was difficult for taxpayers, their agents, the Commissioner and the courts to determine whether s BG 1 or the other provisions of the Act applied to a given

²¹⁵ Inland Revenue “Interpretation Statement (Draft for Comment and Discussion): Tax Avoidance and the Interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007 (16 December 2011).

²¹⁶ Andrew Maples and Adrian Sawyer “The Inland Revenue’s Draft Interpretation Statement on Tax Avoidance – Are We Any Further Ahead” (2012) July/August Asia Pacific Tax Bulletin 331 at 333.

²¹⁷ At 334.

²¹⁸ At 335.

²¹⁹ KPMG “Submission on Tax Avoidance and the Interpretation of Sections BG 1 of the Income Tax Act 2007 (Draft Interpretation Statement)” 7 May 2012 at [1.2]; See also IS at [47], [48].

case (particularly as New Zealand's tax system is now based on self-assessment), the problem facing taxpayers was especially challenging. In this respect, NZICA expressed doubt as to the ability of the IS to provide meaningful guidance as to the application of s BG 1 to the bulk of taxpayers in New Zealand.²²⁰

NZICA also criticised the Commissioner's use of s BG 1, which it likened to a form of "statutory polyfilla." The argument made was that the Commissioner was reluctant to accept that the Act could give rise to an outcome that was not consistent with the Commissioner's legal position, and that he or she would therefore seek to use s BG 1 as a means to achieve a result which more closely accorded with his or her interpretation of the ITA. Despite statements by the Commissioner that s BG 1 will not be used to resolve errors or imperfections in the statute, NZICA argued that this continued to happen at the cost of certainty.²²¹

(b) Statutory Interpretation and the case of *Ben Nevis*

Concerns have been raised over the approach to statutory interpretation contained within the IS. NZLS (in response to the Revenue's view that the parliamentary contemplation test is now the starting point for tax avoidance analysis), argued that the Supreme Court decision in *Ben Nevis* was intended to be evolutionary, rather than revolutionary. Rather than departing radically from the approach set down in *Challenge*, NZLS regarded the Supreme Court as instead having endorsed a "broad" version of the scheme and purpose approach (a possibility also suggested by KPMG).²²² NZLS argued that the IS had failed to put sufficient emphasis on the importance of the language in the Act as the primary means for determining the intention of Parliament.²²³ What Parliament intended could in its view only be divined by what it had said; thus Parliament's contemplation was to be determined primarily by reference to the actual language of the statutory provisions rather than through conjecture as to how Parliament might respond to a given arrangement before a court.²²⁴

(c) Economic Reality

KPMG drew attention to the statement contained within the IS which held that it was a "well-established principle" that a section BG 1 inquiry was not limited to the legal form of the arrangement. KPMG took this to infer that the courts are, or will soon examine the economic

²²⁰ NZICA "Submission on Tax Avoidance and the Interpretation of Sections BG 1 and GA 1 of the Income Tax Act 2007" 19 June 2012 at 4.

²²¹ At 5.

²²² NZLS "Submission on Tax Avoidance and the Interpretation of Section BG 1 and GA 1 of the Income Tax Act 2007" 19 April 2012 at [11]. See also KPMG, above n 219, at [7.2].

²²³ NZLS, above n 222, at [17].

²²⁴ At [18].

substance of a transaction. Yet from KPMG's understanding, the economic substance test was a sub-part of the parliamentary contemplation test designed to aid the courts in determining whether the arrangement is within parliamentary contemplation. Hence, quite what "economic substance" meant was not, in KPMG's view, clear. For instance, a PIE, although specifically said by the IS to be within the contemplation of Parliament was in economic substance indistinct from holding shares of a cash deposit directly. Thus, in KPMG's view, the economic reality test had no explanatory power.²²⁵

(d) Preserving Choice

The NZLS contended that the IS afforded insufficient weight to the taxpayer's freedom to choose between two commercially valid ways of structuring the ownership and use of an asset. While the Commissioner appeared ready to accept that a taxpayer who had not sought to promote a genuine commercial goal independent of tax benefits was in a weaker position under the parliamentary contemplation test, the IS seemed reluctant to acknowledge that the taxpayer was entitled to enjoy tax consequences incidental to the pursuit of a commercial objective.²²⁶

(e) Prior Authorities

KPMG called upon the Commissioner to explain how subsequent developments had been reconciled with the decision in *Peterson*, and to also resolve the two apparently contradictory explanations of *Penny and Hooper* contained within the IS (where one statement had suggested it was the taxpayers' access to funds retained within the companies that rendered the arrangements unacceptable, another implied that it was the fixing of salaries at artificially low levels which contravened s BG 1).²²⁷ Although the two explanations may not be mutually exclusive, it would be useful for Inland Revenue to provide guidance on this point in particular as the precise meaning of the Supreme Court decision in *Penny and Hooper* remains elusive still.

(f) Reconstruction

The IS would seem to regards s GA 1 as affording the Commissioner broad discretion when making adjustments to counteract a tax advantage. In order to counteract the resulting uncertainty KPMG argued in favour of a commercial counterfactual test for a tax advantage, under which the Commissioner would be required to consider a valid commercial transaction that achieved the same commercial outcomes as the alleged tax avoidance arrangement. This

²²⁵ KPMG, above n 219, at [6.1]

²²⁶ At [21]

²²⁷ At [10].

would represent the consideration of a bona fide commercial alternative that might reasonably be expected to have taken place if the particular arrangement had not been entered into, even though this might in some circumstances be to "do nothing." This, in KPMG's view, would go some way towards improving certainty.²²⁸

Q Findings

New Zealand's history with GAARs has been long and checkered. While the matters presented in this Chapter are the subject of further discussion in Chapter Seven, something by way of summation would seem necessary.

Concerning New Zealand's GAAR itself, it may be said that the elements contained within s BG 1 are ambiguous and ill defined. The concepts which it enlists, such as those of "tax avoidance," and the "tax avoidance arrangement" remain unexplained. The inability of s BG 1 to differentiate between purpose and effect is of particular concern, as is the lack of guidance associated with the inclusion of the "merely incidental" threshold. There is also the problem of "objective purpose" associated with s BG 1's application.

New Zealand's approach to statutory interpretation has altered significantly since the advent of *Mangin* in 1970. The largely conservative "scheme and purpose" approach adopted by Richardson J in *Challenge* in 1985 arguably represented an effort to approach tax avoidance pragmatically; to counter the worst excesses while simultaneously placing at the center of the inquiry the text of the provisions themselves. Matters changed with the advent of *Ben Nevis* in 2008, which introduced into tax law the parliamentary contemplation test.

Although exactly how this test operates is unclear, it would seem apparent that it signals a shift in approach on the part of the New Zealand courts. Rather than focusing on the text of the provisions at issue, the application of s BG 1 would now seem to rest on a search for "contrivance" or "artificiality." Somewhat troublingly, however, the tenets of these concepts have never been defined. The burden of proof in relation to contesting the revenue's assessment lies with the taxpayer; under the *Ben Nevis* doctrine, the taxpayer must demonstrate that the steps he or she took were within the purpose and contemplation of Parliament.²²⁹ This essentially represents the courts passing on the "cost" of the uncertainty associated with their approach to the taxpayer. The question of "functionality" remains; how is it that provisions interpreted purposively may nonetheless give rise to a avoidance arrangement that s BG 1 may act invalidate? Can an "avoidance arrangement" have tax effect for some purposes but not for others? Is the will of the legislature at odds with itself?

²²⁸ At [4.1] – [4.4].

²²⁹ *Ben Nevis*, above n 111, at [115]. See also s 149A(2) of the Tax Administration Act 1994.

A recurring theme is the creation of new categories of orthodox and heretical behaviour. Following the Privy Council appeal case of *Challenge* in 1986, the courts adopted a distinction between “avoidance” and “mitigation” before these were replaced by “legitimate tax planning” and “improper tax avoidance” in the 2001 case of *BNZ Investments No 1*. The Supreme Court in *Ben Nevis* abandoned this in favour of “permissible/impermissible” tax avoidance.

It is unclear as to the extent to which these changes in vocabulary represent shifts in the judicial position. Yet the Commissioner’s approach following *Ben Nevis* would seem to have become increasingly aggressive, as the 2010 High Court case of *White*, the 2011 Supreme Court case of *Penny and Hooper*, and 2012 Court of Appeal case of *Alesco* would serve to demonstrate. Arrangements that might once have been regarded as comparatively innocuous are now at risk of being labeled an artifice. However, whether an arrangement may be so characterised can be a source of significant contention, even among jurists; recall, for instance, the differing opinions of the judges which heard the case of *Penny and Hooper*. That the matter was such a source of debate suggests that subjective value judgments are increasingly playing a role in judicial decision making. Accordingly, there is a greater level of uncertainty in respect of where the line lies and the nature of the conduct which will be deemed permissible.

Also problematic is the extent to which the GAAR is relied on to the exclusion of specific provisions. In this respect, *Challenge* and *Ben Nevis* are examples of the tension between the two instruments. It will be recalled that in *Challenge* it was the relationship between the then GAAR, s 99, and s 191 of the Income Tax Act 1976 that was at issue. In a similar manner, the case of *Ben Nevis* raises questions as to the connection between New Zealand’s GAAR, s BG 1 and s DA 1 of the ITA 2007.

Then, there is the issue of the extent to which the advice of the revenue may be relied upon; in this respect, the case of *Alesco* demonstrates that the ground of what may be considered unobjectionable can shift beneath the taxpayer’s feet. Questions also arise in relation to the determination of the counterfactual; why was the taxpayer’s alternative arrangement in that case rejected? Again, there is the risk that what the Commissioner may be targeting are outcomes rather than arrangements per se.

R Conclusion

Given the nature of New Zealand’s recent experience with its GAAR, it is unfortunate that the courts have moved away from the approach set down by Richardson J in *Challenge*. Of this, there is little doubt; in the author’s view, the advent of *Ben Nevis* marked a significant

event in New Zealand's judicial history. As a result, the scheme and purpose approach would seem to have been supplanted, perhaps forever, by the parliamentary contemplation test.

Is this desirable? In addition to the uncertainty this has created for taxpayers, the courts themselves would seem to find it difficult to articulate the tenets of the post-*Ben Nevis* approach, or agree among themselves as to its application. There is also the concern that Inland Revenue, in deploying the GAAR as frequently and in the manner that it does, may be placing upon s BG 1 a burden it was never intended to bear.

Keating and Keating argued in the wake of the Court of Appeal in *Penny and Hooper* that disputes as to the scope of the application of s BG 1 consumed a disproportionate amount of the resources of Inland Revenue, the courts, practitioners and taxpayers; in fact up to 20 to 30 percent of these. The authors regarded the current system as "failing us all," with the lack of precision inherent in GAARs and the lack of guidance forthcoming from both the Commissioner and the courts' simply fueling further disputes. The current law on tax avoidance was "far from what we should expect from a good tax system." Perhaps, as is implicit in the reasoning of Keating and Keating, it is time to give the question of the role apportioned to the GAAR some serious consideration at last.

VII FINDINGS

A Introduction

1 Preliminary Remarks

When the writer first began work on his thesis, he expected there to be a clear and unambiguous distinction between the legal taxation environment created by the United Kingdom's use of a judicial doctrine and those of Canada and New Zealand, which, by contrast, rely on general anti-avoidance rules instead. The writer's preliminary research suggested that countries in the latter category would likely exhibit greater numbers of conceptual legal difficulties than those in the former. This, he reasoned, would likely act to exert a more harmful influence upon the value of certainty within these jurisdictions.

Although the writer regards these suppositions as having proved to be broadly accurate, the role and influence of the courts has also shown to be of the utmost significance to the level of uncertainty within a jurisdiction. In other words, the approach of the courts may act to render the distinction between the effect of the broad application of a judicial doctrine and the constrained application of a GAAR increasingly fine and difficult to articulate, suggesting that the broad spectrum application of a judicial doctrine may in many cases be more detrimental to the value of certainty than the narrow application of a general anti-avoidance provision.¹

All things held equal, however, the use of general anti-avoidance rules would seem to amplify and increase the amount of uncertainty within the tax law to an extent not seen in the application of the UK's judicial doctrine. This "amplifying" effect is in the writer's view chiefly attributable to the reliance of GAAR upon concepts and terms which are ambiguous and conceptually abstract. There would seem an increasing tendency on the part of Revenue departments in the jurisdictions of New Zealand and Canada to have recourse to a general anti-avoidance rule as their weapon of first choice, even when a specific rule might in fact prove more appropriate. These and other matters are explored further below.

¹ As was noted in the Canadian Chapter, shortly after the decisions in *Canada Trustco* and *Mathew* in Canada and *Barclays* and *Scottish Provident* in the UK, Judith Freedman argued that the more recent judgments of the Supreme Court of Canada were arguably more conservative than the tax decisions of the House of Lords. See Judith Freedman "Converging Tracks? Recent Development in Canadian and UK Approaches to Tax Avoidance" (2005) 53(4) Can Tax J: Rev Fiscale Can 1038 at 1039.

2 Order of Procession

This Chapter begins by providing a summation of the recurring themes and ideas present within the experiences of the jurisdictions of the UK, Canada and New Zealand. These include matters ranging from the issue of statutory interpretation to that of “functionality.” Emphasis has been given to highlighting the problems which were common to the jurisdictions explored. A discussion is then presented of the UK’s decision to relinquish its judicial doctrine, in addition to a few comments on the possible future direction of the UK, Canada and New Zealand. A brief conclusion follows.

B Recurring Themes within Canada and New Zealand

1 Conceptual Problems within GAARs

The components contained within GAAR tend to be conceptually abstract and problematic, making their application difficult to determine. For instance, Canada’s GAAR, s 245 contains the notions of the “tax benefit” and the “avoidance transaction” but does not explain what these mean. While a “tax benefit” might be understood as a reduction from a higher to a lower tax position, no indication is given as to how the higher tax position is to be ascertained. Similarly, where an “avoidance transaction” hinges on the presence of “bona fide purposes,” what would constitute these has not been articulated. These difficulties are further compounded by the requirement that the taxpayer bear the onus of rebutting the presence of these two elements; how, in the absence of agreed upon definitions, can the taxpayer be expected to effectively contend with these matters?

In Canada, there have been changes in the standard of the onus that the Minister is required to discharge in order to demonstrate an “abuse” of the Act. While it was first held in *Canada Trustco*² in 2005 that an abuse was required to be “clear and unambiguous,” this was later reduced to the lower evidential threshold of “on the balance of probabilities” in *Lipson*³ in 2009. While this has reverted back to “clear and unambiguous” since *Copthorne*⁴ in 2011, whether it will remain so is unknown. Similar criticisms can be made of the concept of an “abuse or misuse” of the Act contained within s 245. Exactly how this is to be understood remains unclear and the standard by which this is to be determined opaque.

New Zealand’s tax jurisprudence exhibits similar problems. Indeed, it is doubtful whether its GAAR, s BG 1 of the ITA 2007, defines the concepts upon which it relies with any greater success than its Canadian counterpart. For instance, the definition of “tax avoidance” offers

² *Canada Trustco Mortgage Co v R* 2005 SCC 54.

³ *Lipson v R* 2009 SCC 1.

⁴ *Copthorne Holdings Ltd v R*. 2011 SCC 63.

little, if any, insight into the nature of the liability which s BG 1 seeks to target, or how its quantum is to be determined. The definition of “arrangement” is similarly broad and non-specific. The term “avoidance arrangement” extends to any arrangement with the “purpose or effect” of tax avoidance; it does not contain a “bona fide purposes” exemption, meaning that s BG 1 fails to distinguish between the concepts of purpose and effect. However, while there is a caveat in the form of the “merely incidental” threshold, no explanation of its tenets has been provided. Accordingly, it is difficult to see how this can be regarded as any form of caveat at all. Additionally, the taxpayer bears the onus of demonstrating that the arrangement was such as to come within parliament’s contemplation. This is no easy task, owing to the difficulties which the parliamentary contemplation test presents for statutory interpretation, raising the interesting question of whether the application of s BG 1 is in fact possibly more onerous than s 245.

Both New Zealand and Canada employ the device of “objective purpose.” Rather than carrying out an inquiry into the state of mind of those involved in carrying out the arrangement, the courts have allowed the revenue to attribute a “purpose” to the arrangement itself. Yet, the difficulty with the concept is that “purpose” is essentially a function of cognition.⁵ Thus, it is difficult to see how an arrangement can itself have a purpose independent of that of its architect.

2 Statutory Interpretation

Canada’s creation and enlistment of the “unified approach” to statutory interpretation is also problematic, as it seeks to combine a textual, contextual, and purposive approach into one formulation. Yet it is unclear why the use of these elements should work in unison rather in opposition. Would not the application of a “textual” approach work against a “purposive” effort to discern the intent of the legislature? Do the constituent elements of this approach necessary lead in the same direction?

New Zealand has its own share of difficulties, having arguably dispensed with the “scheme and purpose” approach developed by Richardson J in *Challenge*⁶ in 1985 in favour of the “parliamentary contemplation test” arising from *Ben Nevis*⁷ in 2008. Where the former would seem to have represented a pragmatic, largely conservative approach to reconciling the at times disparate policies embedded in the tax law, the latter, by contrast, emphasises a search for the presence of “artifice” or “contrivance.” Under the parliamentary contemplation test, the focus of the inquiry is whether the legislature would approve of the transactions with

⁵ Michael Littlewood “Tax Avoidance, The Rule of Law and the New Zealand Supreme Court” [2011] NZ L Rev 35 at 53.

⁶ *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1986] 2 NZLR 513.

⁷ *Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC).

which the court is confronted. Yet it is difficult to see whether this represents the application of the law or the appropriation of the legislative role. What would seem clear, however, is that decisions will likely turn to a greater extent on the factual matrix of the arrangements themselves. Accordingly, its application is difficult to predict.

There is also the matter of “functionality,” or, in other words, the question of how an arrangement is capable of having “tax effect” so as to give rise to a “tax benefit” or “avoidance transaction” while simultaneously existing outside the purpose of the provisions which it relies upon. Should not such an arrangement be without tax effect, or void *ab initio*? The fact that it is not suggests that a transaction may have tax effect for some purposes but not for others, or that the will of legislature is at odds with itself. Thus, the use of a GAAR alongside the purposive approach to statutory interpretation would seem to present a challenge to the formulation of a consistent approach to statutory interpretation.

3 *Creating Doubt*

The use of a GAAR tends to present problems for other concepts within the law. In Canada, for instance, the case of *Canada Trustco* saw the Canada Revenue Agency contend that the term “cost” should be understood as distinct from its ordinary meaning, and instead be taken to refer to the “amount at risk.” Similarly in *Copthorne* the phrase “in contemplation” contained in s 248(10) of the Canadian Act was held to be capable of being construed both “prospectively” and “retrospectively,” notwithstanding the comments of a then Director of Revenue. Also problematic was the use made in the decision of in the 2005 case of *Mathew*⁸ of the terms “artificiality” and “vacuity;” there was little discussion of how these were to be understood in the context of Canada’s GAAR. Additionally, the characterisation of the abstract concepts of the “tax benefit” and “avoidance transaction” as matters of fact, and the concept of an “abuse or misuse” of the Act as a matter of law has likely injected a certain measure of uncertainty into the distinction between the concepts of fact and law themselves.

New Zealand has seen the continual creation of new categories to distinguish between that behaviour which, for want of better terms, is considered orthodox and that which is regarded as heretical. This has progressed from the original “ordinary/extraordinary” dichotomy enunciated in the 1958 case of *Newton*⁹ to the “avoidance/mitigation” distinction given in *Challenge*,¹⁰ to the categories of “legitimate tax planning/improper tax avoidance” in the 2001 case of *BNZ Investments No 1*.¹¹ Eventually, this took the form of a distinction between

⁸ *Mathew v. R.* 2005 SCC 55.

⁹ *Newton v Federal Commissioner of Taxation* [1958] AC 450 (PC).

¹⁰ *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513 at 561 per Lord Templeman.

¹¹ *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450

that which is “permissible/impermissible” in the wake of *Ben Nevis*. As how these are to be understood remains unclear, however, the reformulation of these categories may have simply acted to reduce the scope of the circumstances under which the taxpayer may act in reliance upon specific provisions from separate categories to a matter of degree within the same category.

4 *General Trumps Specific*

Also of concern is the potential for GAARs to be applied in place of a specific provision which might be better suited to the task. In the Canadian case of *Lipson*, for instance, a significant point of contention among the jurists was the relationship between the specific anti-avoidance rule s 74.5(11) and s 245. In *Copthorne*, the taxpayer’s compelling implied exclusion argument was overlooked for reasons which are unclear. In New Zealand the case of *Challenge* saw a dispute between the jurists as to whether the role of the specific rule s 191 trumped the application of s BG 1.

The case of *Ben Nevis* saw the Revenue make the concession that, but for the GAAR, the taxpayers would have been entitled to the deductions claimed. Yet section DA 1 of the ITA 2007 states that expenditure is tax deductible if it is, inter alia, incurred in deriving assessable income. Interestingly, however, the majority of the Supreme Court felt it possible that the taxpayers would “probably never incur the real expenditure.”¹² This suggests that the use of the specific provision in s DA 1 might have sufficed in place of the GAAR, raising the question of why the revenue would prefer the use of a GAAR to a specific provision. Although there are a few possible answers to this question, a cynic might argue that a GAAR might be viewed as a stronger means for attacking arrangements which the revenue regards with disfavour. That said, the use of a GAAR arguably poses significant problems for the value of certainty that would not arise were a specific provision to be used instead.

5 *Split Decisions*

The use of a GAAR would seem to have a tendency toward producing split or varying decisions. The most notable examples among the cases surveyed in Canada and New Zealand are those of *Lipson*, *Challenge*, and *Ben Nevis*. This might be taken to suggest that decisions involving GAARs involve a certain amount of subjective judgment on the part of jurists. Thus there is the risk that the use of a GAAR may in some instances act as a cloak for the exercise of judicial discretion.

¹² Michael Littlewood “Tax Avoidance, The Rule of Law and the New Zealand Supreme Court” [2011] NZ L Rev 35 at 58.

6 *Can the Advice of the Revenue be relied upon?*

There are concerns in relation to the extent to which taxpayers may act with confidence upon the advice provided by the collectors of revenue.¹³ As has already been noted, in the Canadian case of *Copthorne*, despite the existence of comments made by a then Director of Revenue Canada, the phrase “in contemplation” was read “retrospectively” as well as “prospectively.”¹⁴ Similarly, the 2011 New Zealand case of *Alesco*¹⁵ also saw Inland Revenue in effect change its mind as to what it regarded as acceptable after the fact. This led Connelly and Whittington to observe that changes in the attitudes and approach of the authorities could render transactions that might once have been regarded as offering “permissible” tax advantages the subject of challenge in the years subsequent to their having been entered into.¹⁶

The principle that advice gained from the Revenue should be capable of providing the taxpayer with useful, practical guidance is worth protecting, even if it should mean that the Revenue should suffer some “disadvantage” in the short term. The alternative would seem to risk creating an environment of mistrust between the Revenue and taxpayers, which, from a compliance perspective, may prove to be more “expensive” to the Revenue than the short term “loss” arising from an arrangement that it would seek to disallow.¹⁷

7 *Ascertaining the Counterfactual*

There would seem to be a tendency on the part of the revenue and the courts to disregard the counterfactual advanced by the taxpayer, particularly where these represent the achievement of the same result by other means. For instance, in the 1997 Canadian case of *McNichol*,¹⁸ Canada’s Revenue would seem to have refused to countenance the taxpayers’ submission as to how they might have acted in the alternative chiefly as it would have produced the same outcome. Similarly, in *Alesco*¹⁹ the Court of Appeal was also dismissive of the hypothetical advanced by the taxpayer. Yet this is problematic. Should not the fact that the same outcome might be achieved in a number of ways lend credence to the presumption that the legislature

¹³ Again, it is not always the outcome with which the author quibbles so much as with the process by which it was achieved; this is particularly so with respect to the case of *Alesco*.

¹⁴ *Copthorne*, above n 4, at [50].

¹⁵ *Alesco New Zealand Ltd and Ors v Commissioner of Inland Revenue* [2012] 2 NZLR 252.

¹⁶ Shaun Connelly and Stephen Whittington “The shifting sands of permissible tax advantages” (10 February 2012) 177 NZ Lawyer Online <www.nzlawyer magazine.co.nz>.

¹⁷ In New Zealand, the current position is that the Commissioner of Inland Revenue cannot be estopped on the basis of advice issued (the only exception being binding rulings). This may add perceptions of unfairness and negatively impact upon taxpayer compliance.

¹⁸ *McNichol v The Queen* [1997] 2 CTC 2088.

¹⁹ *Alesco and Ors v Commissioner of Inland Revenue* [2013] NZCA 40 at [71] per Harrison J.

would have allowed it? There would seem to be the risk that the revenue may enlist the GAAR to object not so much to the arrangements into which taxpayers enter so much as to the outcomes to which these give rise

C Themes within the UK

In contrast to the somewhat erratic growth of GAAR jurisprudence, one of the virtues of the UK's judicial doctrine has been its slow and incremental development. Consider the cautious nature of its origins in the 1981 case of *Ramsay*²⁰ against the broader perspective articulated in *Barclays* in 2004;²¹ in each case the pace of change has been slow, gradual and pragmatic.

The *Ramsay* rule (as it was named upon inception) began largely as an exception to the formalistic approach set down in the *Duke of Westminster* in 1936.²² Although, as articulated by Lord Brightman in *Furniss v Dawson* in 1984,²³ it contained reference to the concepts of a "legitimate commercial end" and a "commercial or business purpose," the circumstances to which it could be applied would seem to have had parameters (consider, for instance, the statement of Lord Brightman in that case). Following the case of *McGuckian* in 1997,²⁴ however, the *Ramsay* rule came to be characterised as a principle of statutory construction. This trend continued in *Westmoreland Investments*²⁵ in 2001 in which Lord Hoffmann found against the proposition that the *Ramsay* rule was any sort of "overriding principle." The courts, his Lordship said, had no constitutional authority to impose such a principle upon the law. There was ultimately one principle of construction, and this was to ascertain what Parliament meant by using the language of the statute. Notwithstanding that that this would appear to be, of itself (as Edwin Simpson contended),²⁶ a constitutional imposition, and the reach of the *Ramsay* principle (however it is to be regarded) at its broadest would still seem somewhat less than that of either the Canadian or New Zealand GAARs.

The case of *Westmoreland* was not without difficulty, however. Lord Hoffmann's "commercial/legal" distinction was a problematic innovation without terribly much by way of rationale or underlying principle, particularly as it was unclear how this distinction was to be understood or applied. That this distinction was abandoned by the House of Lords in *Barclays* was almost certainly for the best. The cases that followed largely represented the continuation of the purposive approach established in *McGuckian*. Notable among the comments of the House in *Barclays* was the claim that *Ramsay* had never existed with special

²⁰ *W.T. Ramsay v IRC* [1982] AC 300.

²¹ *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] 1 AC 684.

²² *Commissioners of Inland Revenue v His Grace The Duke of Westminster* AC 1936.

²³ *Furniss v Dawson* [1984] AC 474.

²⁴ *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991.

²⁵ *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311.

²⁶ Edwin Simpson "The Ramsay Principle: A Curious Incident of Judicial Reticence?" (2004) 4 BTR 358.

rules of its own; this, while probably inaccurate, was in some respects necessary if the House was to affirm and entrench the purposive approach. In largely reiterating the sentiments expressed in *Barclays*, the decision in *Tower MCashback* in 2011 presented few changes. Although the outcome of the 2011 case of *Mayes* is perhaps something of a surprise, it may prove not to be terribly consequential. Indeed, as the UK is on the cusp of enacting a GAAR, many of the disputes concerning the approach of the House of Lords to tax avoidance have arguably come to occupy the realm of the academic, rather than the practical.

That said, the UK's case law nonetheless provides a number of important lessons for the maintenance of a pragmatic approach to tax avoidance. Throughout the case law, a recurring theme has been that taxpayers must avoid arrangements which are "artificial" in the sense that they conjure a loss from thin air, or otherwise result in the taxpayer profiting at the expense of the Revenue. In this respect, it must be emphasised that the careful development of UK's case law has meant that the ambit of these terms is not so ambiguous or abstract as their Canadian and New Zealand equivalents. The context, in other words, in which the UK's case law has developed has likely offered a greater level of insight into the circumstances to which its judicial doctrine might be applied. Accordingly, its application has arguably been more predictable. Essentially, the taxpayer must bear the economic burden of the expenditure in order for it to be incurred, and the presence of circularity, although a matter for consideration, is not necessarily determinative. UK case law would suggest that taxpayers would be ill advised to engage in transactions in which the benefit arising from the tax element outweighs that arising from the transaction itself; a loss must be "real" rather than "magical." While this principle may at times prove difficult to apply, the outcomes in its case law have proved to be for the most part reasonably consistent.

Unlike Canada and New Zealand, the UK's approach avoids raising questions of "functionality," as rather than applying a GAAR alongside addition to the purposive approach, it simply deems tax avoidance elements to be without "tax effect." Neither is it "reconstructive." Consequently, the issue of the counterfactual is less prominent. While the UK employs the device of "objective purpose" and places the burden of contesting the Commissioner's assessment on the taxpayer, this is less onerous than the approach employed in New Zealand and Canada owing to the arguably greater level of predictability associated with the application of the *Ramsay* principle.

D Bringing it together: GAARs, Judicial Doctrines and Uncertainty

Even though the ambit of the GAARs deployed in Canada and New Zealand and the UK's judicial doctrine have tended to broaden with time, the judicial doctrine employed in the UK would still seem considerably less onerous than its statutory counterparts. Not all authors would agree with such a proposition, however. In this respect, the recent work of Michael

Littlewood provides an opportunity to bring many of the themes explored in this thesis together.

1 *Five Propositions*

Michael Littlewood, in a presentation²⁷ based on a forthcoming article concluded:²⁸

1. The New Zealand GAAR is the best in the world.
2. Resolving difficult questions incrementally is exactly the strength of the common law.
3. In some fields the subtlety and flexibility of judge-made law is superior to anything achievable by the legislature.
4. Every word added to a GAAR gives the Revenue and taxpayers something extra to argue about.
5. Every added word distracts from the central issue.

2 *The Best in the World?*

Littlewood's propositions represent a thoughtful compilation of conclusions on general anti-avoidance rules. However, there are a few matters on which the writer would respectfully differ. As to the first point, that New Zealand's GAAR remains the best in the world, the writer is skeptical. How is the efficacy or otherwise of a GAAR to be evaluated? By what criteria might this be accomplished? Without greater insight into these matters it is difficult to comment further.

3 *Uncertainty*

On the subject of uncertainty, the "slides" of Littlewood's presentation might be taken to suggest a cautious endorsement of the common law approach adopted in the UK. However, echoing the sentiments of Thomas J in *BNZ Investments No 1*,²⁹ Littlewood in his article opined that while the uncertain scope of the GAAR was problematic in every jurisdiction that had one, the problem of uncertainty seemed to be "even worse in jurisdictions whose tax legislation does not contain such a rule, notably the United Kingdom."³⁰ The uncertainty, in

²⁷ Michael Littlewood "The Drafting of a General Anti Avoidance Rule" (paper presented to the Australasian Tax Teachers Association Conference, January, 2013) The writer has taken the somewhat unusual step of including in his thesis remarks from the presentation based on Littlewood's forthcoming article, as these in his view shed further light on Littlewood's views. The writer should say, however, that he was not in attendance at the presentation itself.

²⁸ Michael Littlewood "The Possibility of Amending New Zealand's General Anti-Avoidance Rule" (2013) 25 NZULR (Forthcoming).

²⁹ *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450 [*BNZ Investments No 1*] at [93] per Thomas J.

³⁰ Littlewood, above n 28, at 20.

Littlewood's view was "attributable not to the GAAR but to the difficulty of defining the scope of the tax."³¹

Thus, while endorsing judge made law in his presentation, it would seem that Littlewood was referring to the development of judge made law under the GAAR, rather than to the UK's judicial doctrine. Yet if in many respects judge made law is to be regarded as superior for its subtlety and flexibility, how meaningful a contribution can the GAAR be said to make to this? Unlike the common law, a GAAR is not the product of "bottom-up" cautious and incremental experimentation in the "laboratory" of commercial jurisprudence, but rather a broad, "top-down" imposition of the legislature. Consequently, the ability of jurists to resolve the conceptual issues raised by a GAAR is inherently limited. This may go some way towards explaining why case law formulated under a GAAR tends to be particularly ambiguous and uncertain, and why it exhibits frequent recourse to amorphous concepts such as those of "artifice" and "contrivance" without much by way of context or explanation as to what these mean.

The argument that the state of the law in the UK is more uncertain than that of jurisdictions without a GAAR is therefore problematic, particularly as the difficulty of defining the scope of a tax is common to all jurisdictions and not confined merely to the legislature of the UK. Therefore, the question is perhaps whether the enactment of a UK GAAR is likely to improve matters. Yet this, in the writer's view, would seem unlikely.

4 *"Rorting" the System?*

On the subject of deterrence, Littlewood characterised the transactions caught by New Zealand's GAAR as "those aimed at rorting the tax system." If they could be discouraged, he wrote, then "so much the better." Of all the schemes to which the GAAR had been recently applied, "none were remotely beneficial to society."³² Yet in the writer's view, whether GAARs are in fact effective at deterring transactions which attempt to "rort" the tax system (however these are to be defined) is debatable; indeed, the mere fact that the transactions to which GAAR has been held to apply were undertaken in the first place might be taken to suggest not a success, but rather a failure, of deterrence.

More broadly, however, as to whether the recent schemes to which GAARs have been held to apply represented an effort to "rort" the tax system, it should be said that it is admittedly difficult to feel much sympathy insofar as arrangements of the sort undertaken in the

³¹ At 20.

³² At 20.

Canadian case of *Mathew* and the New Zealand cases of *Ben Nevis*, *Westpac*³³ and *Alesco* are concerned. Yet there are other cases in which matters are not as clear as they might first appear.

In this respect, the decisions which spring most readily to mind are the Canadian decisions of *Lipson*³⁴ and *Copthorne*³⁵ and the New Zealand decisions of *White*³⁶ and *Penny and Hooper*.³⁷ Both Canadian cases went against the taxpayers despite these (in the writer's view) having an arguable case. Similarly, while *White* went in favour of the taxpayer, whether the Supreme Court ought to have decided *Penny and Hooper* as it did is a hotly contested point; additionally, there is the somewhat troublesome question of what, if any effect, this may have on the decisions of professionals such as the surgeon taxpayers to live and work in New Zealand.³⁸

5 Common Ground

In respect of Littlewood's fourth and fifth points, however, the writer is broadly in agreement. Adding a list of factors to the New Zealand GAAR would not necessarily improve matters. GAARs, by their very nature, tend to be inherently cumbersome, and it is difficult to see what would be gained by making further additions to New Zealand's GAAR unless it could be said that these would provide taxpayers with practical, meaningful guidance as to the circumstances to which it would apply, and those to which it would not. That said, however, Trombitas has offered several interesting suggestions of his own as to how the level of certainty associated with the use of the GAAR in New Zealand might be improved.³⁹

³³ Michael Littlewood has argued that the transactions carried out by the taxpayer in *Westpac Banking Corporation v Commissioner of Inland Revenue* can be characterised as "pre-tax negative" and "post-tax positive" in the sense that they would produce losses which increased the taxpayer's after tax profits on their other income by much more than the losses made on the transactions. See Michael Littlewood "The Possibility of Amending New Zealand's General Anti-Avoidance Rule" NZULR (forthcoming).

³⁴ *Lipson v R* 2009 SCC 1.

³⁵ *Copthorne Holdings Ltd v R* 2011 SCC 63.

³⁶ *White v Commissioner of Inland Revenue* (HC) (2010) 24 NZTC 24,600.

³⁷ *Penny v Commissioner of Inland Revenue* [2012] 1 NZLR 433.

³⁸ While the decision of *Penny and Hooper* may have no such effect at all, as it has already been argued that any increase in the level of uncertainty within a jurisdiction may carry with it implications for the movement of capital (including that of the human variety), it would seem improper to leave the matter unmentioned.

³⁹ These are further discussed below. See Eugen Trombitas "The Conceptual Approach to Tax Avoidance in the 21st Century: When the Statute Gives But the GAAR Can Take Away" (2009) 15 NZJTL 352.

E Why did the UK reconsider its use of a Judicial Doctrine?

It might be asked, however, why, if the UK's judicial doctrine is so virtuous, it is being abandoned in favour of a GAAR; does this not undermine the writer's case that judicial doctrines are more conducive to the promotion of certainty than a GAAR? To the contrary, this state of affairs, rather than undermining the writer's case, could instead be taken to corroborate it; it may simply be that the political and economic environment in the UK is now such as to render the value of certainty considerably less important in the eyes of policy makers than it once was. The adoption of a GAAR may simply represent a desire on the part of the UK to "clamp down" on aggressive tax planning, in order to give effect to the value of equity, for instance, instead.

If so, given the events of recent years, it is perhaps easy to see why the UK might wish to do this. The fallout from the Global Financial Crisis and the public opprobrium directed toward the banking and finance industry resulted in a number of measures designed to curtail the financial industry's worst excesses⁴⁰ (consider, for instance, the renewed calls for the imposition of a "Tobin Tax").⁴¹ Developments in the field of tax affairs have also received attention from state forums such as the G8⁴² and OECD.⁴³ In this climate, the proposal for a UK GAAR received a broadly sympathetic hearing, even from some in the financial industry.

Compounding this, recent UK case law in the wake of *Barclays* has shown signs of a more cautious and conservative approach on the part of its jurists, much to the displeasure of some commentators.⁴⁴ Additionally, there is the increasing recourse had to GAARs by the Revenue departments of the UK's trading partners to consider (e.g. South Africa, Australia, Canada and New Zealand).⁴⁵ If the experiences of the Canada and New Zealand are anything to go by, the use of a GAAR would seem to offer a reasonable rate of success in challenging schemes and arrangements which, for one reason or another, their respective departments of revenue view with disfavour.

⁴⁰ Consider the concern expressed at the tax bills attaching to the UK operations of multinational entities such as Starbucks and Google. Vanessa Barford and Gerry Holt "Google, Amazon, Starbucks: The rise of 'tax shaming'" (4 Dec 2012) BBC News Magazine <www.bbc.co.uk>.

⁴¹ This is a tax on financial transactions which was originally mooted by Nobel prize winning economist James Tobin Andrew Walker "What is a Tobin Tax" (2 Nov 2011) BBC Business News <www.bbc.co.uk>.

⁴² Patrick Wintour "Tax Avoidance Clampdown Wins Support of G8 Leaders" (18 June 2013) Guardian <www.guardian.co.uk>.

⁴³ Phillip Inman "OECD Calls for Crackdown on Tax Avoidance by Multinationals" (12 February 2013) Guardian <www.guardian.co.uk>.

⁴⁴ Consider, for instance, the role which the case of *Mayes v Revenue and Customs Commissioners* [2011] EWCA Civ 407; [2011] STC 1269 (CA (Civ Div)) may have played in lending impetus to calls for a GAAR. See also Helen Lethaby "Aaronson's GAAR" (2012) 1 BTR 27.

⁴⁵ PWC "Observations of the General-Anti Avoidance Rules in the Asia Pacific Region" (2012) Asia Pacific Tax Notes 2 at 2.

It is also probably accurate to say that, in an increasingly capital-mobile world, states are becoming increasingly preoccupied with the security and protection of their sources of revenue. In this respect, GAARs are perhaps looked upon as a superficially easy and indispensable tool of revenue collection. Whether they are in fact as effective as their proponents might claim them to be, however, is open to debate.

F Whither the Future?

If general anti-avoidance rules are to remain in use in the jurisdictions of the British Commonwealth, are there measures that might improve the level of certainty associated with their application? Some academics think so. For instance, Cassidy argued that New Zealand's s BG 1 should be reviewed in such a way as to provide greater legislative direction as to where the line between legitimate tax planning and tax avoidance should be drawn.⁴⁶ Her suggestion was that s BG 1 should include "badges of tax avoidance" in a way similar to the South African GAAR, Part IIA of Chapter III of the Income Tax Act 1962. Cassidy argued that the list of tax avoidance indicia provided greater certainty than, in the case of New Zealand, a stand-alone parliamentary contemplation test. While uncertainty would remain in marginal cases, Cassidy contended that a checklist of "relevant factors" would assist in providing taxpayers with greater certainty.⁴⁷

Littlewood, however, expressed reservations as to the utility of amending s BG 1 in this way.⁴⁸ Although noting that jurisdictions such as Hong Kong and Australia had amended their GAAR to include lists of factors supposedly indicative of avoidance, Littlewood argued such lists were counterproductive on the grounds that they did not offer any guidance as to the weight to be attached to each item on the list, but rather merely required the courts to consider the factors listed and somehow reach a conclusion. In Littlewood's view, the factors listed fell broadly into two categories; those that were irrelevant to the facts of the particular case, or those which the court would have considered anyway. Consequently, he wrote, the list added nothing other than an extra layer of complexity.⁴⁹

Trombitas, however, argued that to improve certainty, more direct measures were required.⁵⁰ Trombitas' suggestions included, amongst other things, that the onus of proving tax avoidance be made to lie with the Commissioner,⁵¹ that the GAAR should only be said to

⁴⁶ Julie Cassidy "The Duke of Westminster Should Be 'Very Careful When He Crosses the Road' in New Zealand: The Role of the New Zealand Anti-Avoidance Rule" [2012] NZ L Rev at 32.

⁴⁷ At 33.

⁴⁸ Littlewood, above n 12, at 67, 68.

⁴⁹ At 68.

⁵⁰ Trombitas, above n 39.

⁵¹ This was chiefly due to the risk of a GAAR being used to rewrite (or to make up the law)

apply if the relevant arrangement is inconsistent with the scheme and purpose of the legislation,⁵² and the formulation of a dominant purpose test. Trombitas also suggested a clarification of the relationship between the GAAR and other provisions in the tax legislation, as well as the removal of the “effect” requirement contained in s BG 1. Trombitas also argued that if Parliament had a problem with transactions entered into solely to “construct” a tax advantage, then this should be spelt out, along with the criteria relevant to this determination, and so forth.⁵³

While the writer concurs with Littlewood that the addition of factors would not improve matters, the writer would nonetheless be interested to hear more from Cassidy as to the manner in which these might be constructed and applied. Trombitas’ views also have considerable merit.

G Conclusion

Although the experiences of the jurisdictions surveyed have differed, they also exhibit a number of commonalities. This would tend to lend credence to the idea that there is, within the concept of tax avoidance itself, a set of common conceptual problems. Given the extent to which the themes explored above have made themselves felt in the jurisdictions surveyed, there would seem every reason to believe that these will not be resolved at any stage in the near future.

The more interesting question, therefore, is how the courts of the UK, Canada, and New Zealand will deal with them. Will they stay the present course and emphasise a “purposive” approach to statutory interpretation, or might there be a swing back to the more formalistic approach of the past? Will the GAARs of Canada, New Zealand (and shortly the UK) in the future be subject to a more aggressive or more conservative application? What role will the value of certainty play in formulating the future tax policies of these jurisdictions? While the writer is unsure as to the answers to these questions, he is confident that the results, whatever they are, will certainly be worth watching.

⁵² This having been determined with respect to what Trombitas terms the unique and deliberate tax rules. See Trombitas above, n 39 at 354.

⁵³ At 354.

VIII CONCLUSION, LIMITATIONS AND SUGGESTIONS FOR FUTURE RESEARCH

A Introduction

1 Preliminary Remarks

Throughout this thesis, the writer has maintained that, in keeping with Smith's pronouncement,¹ the value of certainty is of integral importance in ensuring a functional and efficient tax system.

If, however, tax legislation is to promote certainty it would seem only proper that it should bind the revenue as much as taxpayers. The risk inherent to the use of a GAAR is that the courts will increasingly begin to deviate from the task of interpreting and applying the law, and instead assume the roles of ex post facto legislators. If certainty is to be maintained, then the use of GAARs should be approached cautiously.

2 Order of Procession

This Chapter commences by discussing matters pertaining to the drafting and passage of fiscal legislation, before progressing to a presentation of the limitations of this thesis, and to suggestions for further research.

B Conceptual Considerations

1 The Question of what the Legislation Allows

Throughout this thesis, the writer has contended that, if the value of certainty is to be preserved, then the use of GAARs should be restricted and minimised. That said, there are a number of responses to this view which it would seem only proper to consider.

Foremost amongst these is the argument that to confine the application of a general anti-avoidance rule will hamper the ability of the courts to deal with tax avoidance. With respect, however, such an argument misses the essential point of the discussion which is that the role of the courts is not to deal with the problem of tax avoidance so much as to interpret and

¹ As Smith opined: "The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty." Adam Smith *An Enquiry into the Wealth of Nations* (5th Ed, London: Methuen & Co., Ltd. 1904) Library of Economics and Liberty <www.econlib.org> at V 2.26.

apply the law; it is worth remembering that this is the essential role of the judiciary to which all other considerations are ancillary. It is, after all, for the legislature to clearly and plainly articulate its intent, and to anticipate as far as possible any difficulties or externalities that the expression of its will should create. Judicial interpretation does not extend to the post hoc remedy of legislation which is considered defective. The presence of legislative defects is therefore not so much an argument for judicial activism so much as the careful drafting of provisions. Perhaps if greater attention was directed toward providing the courts and taxpayers with more useful, reliable information and guidance, the need for a GAAR might be much reduced. The primary purpose of tax legislation is, (as Gideon argued),² to provide guidance to the compliant rather than to curb the excesses of a few. An emphasis on clear and lucid legislation might see the number of “contrived” schemes much reduced.

2 *Drafting with Accuracy*

This leads to what is perhaps the most important point of all, the need for the legislature to draft fiscal legislation which is both cohesive and consistent. If legislation is clear, simple and transparent, then it would seem less likely to cause difficulties at a later stage. How many of the problems arising in the jurisdictions surveyed might have been avoided if a little extra care had been taken at the preliminary stages? Of course, while no legislature can foresee every possible contingency, it can however ensure that the measures which remedy its deficiencies do not come at the expense of certainty. As Trombitas argued, once it is accepted that Parliament can impose taxes through complex deliberate tax rules, it must follow that Parliament can (and should) stipulate what is, and what is not, a permissible use of the same tax rules.³ The claim that the tax law is too complex for the legislature to contend with in the absence of affording the courts greater discretion (in, for instance, the form of a GAAR) is one which confronts every generation. Yet if the legislature regards itself as capable of imposing tax, it hardly claim to be able unable to do so carefully.

The use of a GAAR to “wallpaper” over the inconsistencies, oversights or drafting errors present within legislation is inadvisable if only for the reason that it creates a disincentive for improvement. If the frequency of errors is to be reduced, then it would seem only to follow that their performance must be sufficiently costly as to discourage their repetition. From this perspective, the use of a GAAR to “wallpaper” over difficulties contained within fiscal legislation simply “passes on” the cost of their presence to the taxpayer in the form of increased compliance costs and uncertainty. Is not the same reasoning, after all, inherent in the claim that taxpayers who engage in tax avoidance arrangements should incur the costs

² Kenneth Gideon “Assessing the Income Tax: Transparency, Simplicity, Fairness” (1999) 25 Ohio NUL Rev 101 at 106.

³ Eugen Trombitas “The Conceptual Approach to Tax Avoidance in the 21st Century: When the Statute Gives But the GAAR Can Take Away” (2009) 15 NZJTL 352 at 389.

arising from their “reconstruction” at the hands of the courts and even penalties besides? Of course, this is not to say that the legislature should be able to foresee every possible contingency before it arises, but rather that it should have as much reason to tread thoughtfully and carefully as possible.

C Practical Matters

The injudicious use of a GAAR arguably presents concerns for the collectors of revenue. Indeed, it would not be without a trace of irony if the very measure designed to improve the fiscal security of the jurisdictions of the UK, Canada and New Zealand in fact contributed to a decline in their respective rates of taxable economic activity or to an increase in the use of asset sheltering devices or capital flight.

Merely the fact that policy makers may have come to view the value of certainty in a less favourable light in recent decades does not necessarily mean the same can be said of those involved in trade and commerce. It is also by no means inconceivable that an excessive reliance on GAARs may contribute to the flourishing of bureaucracy and administrative inefficiency. For all the faith placed in the “deterrent effect” of GAARs, there is the risk that taxpayers may in fact take advantage of the increased level of uncertainty created by a GAAR and, by “gaming the system,” end up better off. Who does the presence of uncertainty advantage? The answer is perhaps not as clear as the supporters of GAARs might suggest.

D Limitations and Scope for Further Research

1 Limitations

(a) Certainty

Any effort to compare the implications posed by the approach of three jurisdictions for the value of certainty must come with a number of qualifications and caveats. Although the writer has appealed to the value of certainty, it must be acknowledged that owing partly to cultural and political differences, not all jurisdictions will necessarily understand the definition of certainty in the same way or have the same conception of what it would mean to give this value full effect. Even within these jurisdictions, there will be disputes and differences in understanding among policy makers. Additionally, the extent to which these jurisdictions desire to give effect to the value of certainty may also differ.

Even though the writer has sought to adopt the concept of certainty as advanced by Smith (in conjunction with authors such as Dicey and Hayek), the writer must acknowledge that his own culture and political environment has likely influenced his conceptual understanding. While the fact that the jurisdictions surveyed are members of the British Commonwealth

(and, accordingly, share a common legal history) may act to mitigate against the possibility that one or more may possess a concept of certainty which is widely disparate from another, there is the influence of globalisation to consider; increasing cultural and economic ties to nations outside the “Anglosphere” may have influenced the understanding and direction of public policy within these jurisdictions. The extent of this influence is indeed something to reflect upon.

(b) Differing Instruments

Owing chiefly to the fact that the nature of judge made law and statute is inherently different, another limitation (or rather a consequence of the material, perhaps) lies in the inability of the writer to present and consider the UK’s judicial doctrine and the GAAR of New Zealand and Canada in exactly the same way. In the UK Chapter, the emphasis is chiefly upon an examination of the extent to which one articulation of the *Ramsay* rule differs from another in an effort to discern and its tenets and parameters. By contrast, both the Canadian and New Zealand Chapters open with an analysis of the concepts contained with each jurisdiction’s respective GAAR before proceeding to consider their application in the light of subsequent case law. That efforts to draw lessons and make comparisons can at times be a problematic where such inherently different instruments are concerned must be acknowledged

(c) Interpretation Statements and Guidance

That the instruments that the UK, Canada and New Zealand deploy to combat tax avoidance are the subject of differing levels of guidance and that this guidance can prove to be of varying quality and utility is a limitation of this thesis. As has been noted, while HMRC has made a large amount of information available on its website as to how it envisions its GAAR operating, as the UK’s GAAR has yet to be enacted and applied, there is considerable doubt as to it will in fact operate in practice. In respect of Canada, there is perhaps less information emanating from its Revenue than might be desired. New Zealand’s Inland Revenue recently issued a Draft Interpretation Statement designed to offer insight into the manner in which it deals with tax avoidance. However, as has been noted, this has both been criticised and remains in draft

(d) A Balancing Act?

A consistent theme throughout this thesis has been the tension between the use of general and specific provisions. While the writer’s focus on the value of certainty has resulted in a tendency to prefer the use of specific rules, he has never sought to argue that general rules should be done away with in entirety. Rather, in the writers' view, the essential question is one of where the balance between the use of the two forms of rule should be struck. Beyond this, however, further value judgments would seem necessary to determine more precisely the

desired level of certainty within a jurisdiction. Although to delve into this matter is beyond the scope of this thesis, it is perhaps a matter for further research; how, for instance, would the level of certainty within a jurisdiction be measured? What would constitute an optimal level of certainty? These and other such questions remain to be explored.

(e) Range of Cases Surveyed

Throughout this thesis, the writer has sought to emphasise and focus upon the cases within the jurisdictions surveyed which are of the most significance for each jurisdiction. While it is hoped that this approach has resulted in the presentation of an image which is as consistent as possible, there is the risk that this may have come at the expense of the omission of some cases which are influential or otherwise present matters of interest. Had more space been available, the writer would have been free to expand the range of cases surveyed further.

For instance, in the UK, the line of recent prominent authority so far as income tax avoidance is concerned is at times regarded as commencing with *Ramsay*,⁴ weaving itself through the cases of *Burmah*,⁵ *Furniss*,⁶ *Craven*,⁷ *Ensign*,⁸ *McGuckian*,⁹ *Westmoreland*,¹⁰ *Scottish Provident*¹¹ and *Barclays*.¹² In addition, there are also the recent cases of *Tower MCashback*¹³ and *Mayes*¹⁴ to consider. This list, however, is by no means intended to be exhaustive, if indeed it were capable of ever being so. In the recent case of *Mayes*, for instance, in addition to the UK cases already given, attention was also drawn to the Court of Appeal (Civil Division) case of *Frankland v IRC*,¹⁵ the decision of the Special Commissioners in *Campbell v IRC*,¹⁶ and the decision of the Privy Council in the Jamaican case of *Carreras Group v Stamp Commissioner*.¹⁷ The case of *Collector of Stamp Revenue v Arrowtown Assets Ltd*¹⁸ should also not be forgotten. There are, in addition to these, many other UK decisions which

⁴ *WT Ramsay Ltd v IRC* [1982] AC 300.

⁵ *Inland Revenue v Burmah Oil Co. Ltd.* [1982] SC (HL) 114.

⁶ *Furniss v Dawson* [1984] AC 474.

⁷ *Craven v White* [1988] STC 476.

⁸ *Ensign Tankers (Leasing) Limited v Stokes* [1992] 1 AC 655.

⁹ *IRC v McGuckian* [1997] 1 WLR 991.

¹⁰ *MacNiven (Inspector of Taxes) v Westmoreland Investments Limited* [2001] UKHL 6.

¹¹ *IRC v Scottish Provident Institution* (2004) 76 TC 538.

¹² *Barclays Mercantile v Mawson* [2004] UKHL 51.

¹³ *Commissioners for Her Majesty's Revenue and Customs v Tower MCashback LLP 1 and another* [2011] UKSC 19.

¹⁴ *Mayes v Revenue and Customs Commissioners* [2011] EWCA Civ 407; [2011] STC 1269 (CA (Civ Div)).

¹⁵ *Franklin v IRC* [1997] STC 1450.

¹⁶ *Campbell v IRC* [2004] STC 396.

¹⁷ *Carreras Group v Stamp Commissioner* [2004] STC 1377; [2004] UKPC 16.

¹⁸ *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 66.

present various points of interest which constraints of space simply made it impossible to include.

In much the same way the writer has sought to concentrate on the more prominent of the recent cases in his discussion of the legal position in Canada. As a result, particular attention has been paid to the cases which have followed in the wake *Canada Trustco*¹⁹ (in which the Supreme Court laid out its present approach to dealing with Canada's GAAR). Thus, in addition to the cases of *Stubart*,²⁰ *McNichol*,²¹ there has been an emphasis on the cases of *Canada Trustco*, *Mathew*,²² *Lipson*²³ and *Copthorne*.²⁴ There are, however, several decisions that might also have been included also, such as the decision of the Supreme Court in *Shell Canada Ltd v R*²⁵ or the Federal Court of Appeal in *OSFC Holdings Ltd v Canada*,²⁶ among others. Constraints of space have unfortunately meant that it was not possible for the writer to include a discussion of all the decisions that he might have wished to.

Likewise, while the discussion of New Zealand's legal position could have included other decisions, the writer has sought to present those which have made the greatest contribution to shaping its tax jurisprudence. The selective survey of cases is in many respects a product of the thematic approach which the writer has taken to the subject of income tax avoidance, teasing out recurring principles, themes and difficulties from prominent decisions in the law of tax avoidance within the jurisdictions surveyed. Although, as with any undertaking, there is the risk that the writer may have overlooked a decision of significance, the thematic approach might perhaps be said to mitigate against the implications of such an eventuality through the likelihood that, despite the possibility that an overlooked decision might present one or more additional points of interest, these would nonetheless very likely be in keeping with, or reconcilable to, many of the themes and ideas which have erstwhile been the subject of discussion.

(f) Jurisdictions Surveyed

Perhaps the most significant limitation of this thesis, however, lies in its ability to survey only three jurisdictions; the UK, Canada and New Zealand. This is chiefly due to the sheer volume of information which it is necessary to report and present to the reader before the legal principles and consequences can be discussed. This is especially evident in the UK Chapter,

¹⁹ *Canada Trustco Mortgage Co v R* 2005 SCC 54.

²⁰ *Stubart Investments Ltd v R* [1984] 10 DLR (4th) 1.

²¹ *McNichol v The Queen* [1997] 2 CTC 2088.

²² *Mathew v. R.* 2005 SCC 55.

²³ *Lipson v R* 2009 SCC 1.

²⁴ *Copthorne Holdings Ltd v R.* 2011 SCC 63.

²⁵ *Shell Canada Ltd v R* [1999] 3 SCR 622 (SCC).

²⁶ *OSFC Holdings Ltd v Canada* 2001 FCA 260.

where a survey of both the factual matrix and judicial pronouncements contained within each case of significance are almost inseparable from the “organic” development of the judicial doctrine itself. Additionally, as no expressions of the common law doctrine have ever been exactly identical, there is often as much need to focus on their Lordships’ treatment of prior authority as on the outcomes reached in each case. Consequently, there is a great deal more which could be said about the UK. Yet the writer derives some comfort from the likelihood that the measure of a full and complete picture of the UK’s approach to tax avoidance would likely be in volumes, rather than chapters or pages.

Yet if decisions in respect of what to include and what to exclude have been difficult, then that relating to the choice of jurisdictions has been even more so. In this respect, the writer would like very much to have included a Chapter on the Australian experience. However, the fact that Australia’s GAAR, Part IVA, is presently undergoing reform (coupled with the constraints of space) meant that this would simply not be possible. Also, as any effort at evaluating the implications of these instruments for the value of certainty has in one sense to be carried out with a reference to contrasting examples, the writer was concerned that Australia’s experience shared almost too many similarities to that of New Zealand. Thus, the decision was taken, albeit reluctantly, not to include Australia. Had this been a doctoral thesis, however, the experience of Australia would have very likely been included. Additionally, some discussion of the legal position in Hong Kong might also have proved profitable.

2 Suggestions for Further Research

(a) The Nature of Tax Avoidance More Generally

Although theories and definitions of tax avoidance abound, it is relatively rarely that attention is drawn to the inherent conceptual difficulties that these present. In this respect, Trebilcock, Nitikman and Littlewood are to be commended for their efforts in articulating the difficulties associated with the concept of tax avoidance and legislative efforts directed toward its prohibition. There is, however, room for other authors to build upon and extend their work.

(b) The Value of Certainty

Although the writer undertook to discuss Smith’s concept of certainty and its importance for the rule of law, there is nonetheless a great deal more that could have been said on this point. That in modern times the value of certainty has arguably been overlooked in favour of that of equity provides ample opportunity for further enquiry. How did the value of certainty come to occupy a place of such prominence in Smith’s mind amidst the pantheon of values? What role has the value of certainty played in the history of tax collection? What lessons can be gleaned from its embrace and disregard? This would likely involve a consideration of

historical milestones such as the Magna Carta, and the American Revolution, in addition to other matters of historic significance.

(c) Drawing a Line

If the value of certainty is to be afforded greater importance, then there will have to be further discussion to what extent it ought to be enhanced, and how. This would not only require further research and discussion into various conceptions of certainty, but also how it is to be understood and measured. There is also a great deal of room for further research into the optimal combination and use of general and specific rules which best produces the desired level of certainty within a jurisdiction. This would, however, be a substantial undertaking.

(d) The Development of the UK

The development of the UK's judicial doctrine (and its approach to tax avoidance more generally) presents significant scope for further research, particularly beyond the realm of better known cases such as *Ramsay*, *Furniss*, and *Burmah*. How, for instance, did the lower courts contend with these cases? How far was the *Ramsay* principle extended by other jurists? These matters merit consideration. Also of importance will be the charting of the UK's experience following the enactment of its proposed GAAR, in addition to the extent which its experience shares similarities with that of jurisdictions such as New Zealand, Canada and Australia.

(e) The Australian Experience

Further research into the Australian position to date would, in the writer's view, also be of considerable value. This might include, for instance, a comparison of the case law decided under the now defunct s 260 with that heard under Part IVA of the Income Tax Assessment Act 1936. Additionally, it would be most interesting to observe whether, in the years from now, there had been any substantive change in the approach of the Australian Courts following the adoption of the proposed reforms to Part IVA.

(f) GAAR More Generally

One of the most pressing questions this thesis raises is the role apportioned to GAARs, and their effectiveness at combating tax avoidance. How useful an ally have they proved to the jurisdictions which make use of them? To what extent have the concerns expressed by their critics been borne out in practice? How do they impact upon taxpayer behaviour? Further research into such matters might assist in better informing the decision making of policy makers.

E Conclusion

The law of tax avoidance is an incredibly complex and difficult area of law for legislators, policy makers, jurists, tax advisors and taxpayers alike. In emphasizing the role of certainty among the pantheon of values within the tax law, Smith clearly and lucidly articulated not only his rationale for so holding, but also the consequences that he considered would follow from its displacement. From these, implications for the rule of law, fairness and simplicity, commerce, public policy, and fiscal security follow.²⁷

In focusing on the concern posed by, in particular, the use of general anti-avoidance rules to the value of certainty, it is worth reiterating that the writer would not wish to give the impression that these should be abolished. Neither, it should be said, does this thesis advocate a return to the rigid and uncompromising formalism of the past. Rather, from the perspective of certainty, the writer's concern lies with the increasingly prominent role afforded to these provisions, the proliferation of problematic case law, and the increasing uncertainty this tends to cause for taxpayers in attempting to order their affairs. While the UK's judicial doctrine has admittedly not been without its share of difficulties, it would nonetheless seem to have provided a pragmatic middle path by which gregarious examples of tax avoidance could be tackled while still allowing taxpayers some measure of assurance in respect of the forms of dealings which would remain largely free from interference. It is therefore perhaps a little unfortunate that UK will soon act to adopt a GAAR of its own.

There are, however, a variety of simple steps that could be taken by nations with a general anti-avoidance rule to improve the level of certainty within their borders. These range from modifying their general rules in order to narrow their ambit and the circumstances in which they may be applied, to providing more targeted and specific rules to address the problem areas from which the more difficult tax related disputes arise. It is likely that the latter measure, in particular, would contribute to the production of more consistent and elegant solutions to complex issues and assist taxpayers in structuring their affairs in such a way as not to fall foul of the revenue authority. Otherwise, there is the risk that the direction of tax policy will increasingly come to be the domain of the judiciary, a function for which it is improperly equipped; such matters remain (as they must) the domain of the legislature.

Given the prevailing trend within the nations of the British Commonwealth toward the adoption of general anti-avoidance rules, however, there would seem little reason to believe that they will be departing any time soon. This means that, for better or for worse, taxpayers will just have to learn to manage the uncertainty as best as they can.

²⁷ Smith, above, n 1.

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APPENDIX

FINANCE BILL 2013 (UK) PART 5 GENERAL ANTI- ABUSE RULE

203 General anti-abuse rule

- (1) This Part has effect for the purpose of counteracting tax advantages arising from tax arrangements that are abusive.
- (2) The rules of this Part are collectively to be known as “the general anti-abuse rule”.
- (3) The general anti-abuse rule applies to the following taxes—
 - (a) income tax,
 - (b) corporation tax, including any amount chargeable as if it were corporation tax or treated as if it were corporation tax,
 - (c) capital gains tax,
 - (d) petroleum revenue tax,
 - (e) inheritance tax,
 - (f) stamp duty land tax, and
 - (g) annual tax on enveloped dwellings.

204 Meaning of “tax arrangements” and “abusive”

- (1) Arrangements are “tax arrangements” if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements.
- (2) Tax arrangements are “abusive” if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including—
 - (a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,
 - (b) whether the means of achieving those results involves one or more contrived or abnormal steps, and
 - (c) whether the arrangements are intended to exploit any shortcomings in those provisions.
- (3) Where the tax arrangements form part of any other arrangements regard must also be had to those other arrangements.
- (4) Each of the following is an example of something which might indicate that tax arrangements are abusive—
 - (a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,
 - (b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and
 - (c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid,

but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.

- (5) The fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive.
- (6) The examples given in subsections (4) and (5) are not exhaustive.

205 Meaning of “tax advantage”

A “tax advantage” includes—

- (a) relief or increased relief from tax,
- (b) repayment or increased repayment of tax,
- (c) avoidance or reduction of a charge to tax or an assessment to tax,
- (d) avoidance of a possible assessment to tax,
- (e) deferral of a payment of tax or advancement of a repayment of tax, and
- (f) avoidance of an obligation to deduct or account for tax.

Counteracting the tax advantages

- (1) If there are tax arrangements that are abusive, the tax advantages that would (ignoring this Part) arise from the arrangements are to be counteracted by the making of adjustments.
- (2) The adjustments required to be made to counteract the tax advantages are such as are just and reasonable.
- (3) The adjustments may be made in respect of the tax in question or any other tax to which the general anti-abuse rule applies.
- (4) The adjustments that may be made include those that impose or increase a liability to tax in any case where (ignoring this Part) there would be no liability or a smaller liability, and tax is to be charged in accordance with any such adjustment.
- (5) Any adjustments required to be made under this section (whether by an officer of Revenue and Customs or the person to whom the tax advantage would arise) may be made by way of an assessment, the modification of an assessment, amendment or disallowance of a claim, or otherwise.
- (6) But—
 - (a) no steps may be taken by an officer of Revenue and Customs by virtue of this section unless the procedural requirements of Schedule 41 have been complied with, and
 - (b) the power to make adjustments by virtue of this section is subject to any time limit imposed by or under any enactment other than this Part.
- (7) Any adjustments made under this section have effect for all purposes.

207 Consequential relieving adjustments

- (1) This section applies where—
 - (a) the counteraction of a tax advantage under section 206 is final, and
 - (b) if the case is not one in which notice of the counteraction was given under paragraph 12 of Schedule 41, HMRC have been notified of the counteraction by the taxpayer.
- (2) A person has 12 months, beginning with the day on which the counteraction becomes final, to make a claim for one or more consequential adjustments to be made in respect of any tax to which the general anti-abuse rule applies.
- (3) On a claim under this section, an officer of Revenue and Customs must make such of the consequential adjustments claimed (if any) as are just and reasonable.

- (4) Consequential adjustments—
 - (a) may be made in respect of any period, and
 - (b) may affect any person (whether or not a party to the tax arrangements).
- (5) But nothing in this section requires or permits an officer to make a consequential adjustment the effect of which is to increase a person's liability to any tax.
- (6) For the purposes of this section—
 - (a) if the claim relates to income tax or capital gains tax, Schedule 1A to TMA 1970 applies to it;
 - (b) if the claim relates to corporation tax, Schedule 1A to TMA 1970 (and not Schedule 18 to FA 1998) applies to it;
 - (c) if the claim relates to petroleum revenue tax, Schedule 1A to TMA 1970 applies to it, but as if the reference in paragraph 2A(4) of that Schedule to a year of assessment included a reference to a chargeable period within the meaning of OTA 1975 (see section 1(3) and (4) of that Act);
 - (d) if the claim relates to inheritance tax it must be made in writing to HMRC and section 221 of IHTA 1984 applies as if the claim were a claim under that Act;
 - (e) if the claim relates to stamp duty land tax or annual tax on enveloped dwellings, Schedule 11A to FA 2003 applies to it as if it were a claim to which paragraph 1 of that Schedule applies.
- (7) Where an officer of Revenue and Customs makes a consequential adjustment under this section, the officer must give the person who made the claim written notice describing the adjustment which has been made.
- (8) For the purposes of this section the counteraction of a tax advantage is final when the adjustments made to effect the counteraction, and any amounts arising as a result of those adjustments, can no longer be varied, on appeal or otherwise.
- (9) Any adjustments required to be made under this section may be made—
 - (a) by way of an assessment, the modification of an assessment, the amendment of a claim, or otherwise, and
 - (b) despite any time limit imposed by or under any enactment other than this Part.
- (10) In this section “the taxpayer”, in relation to a counteraction of a tax advantage under section 206, means the person to whom the tax advantage would have arisen.

208 Proceedings before a court or tribunal

- (1) In proceedings before a court or tribunal in connection with the general anti-abuse rule, HMRC must show—
 - (a) that there are tax arrangements that are abusive, and
 - (b) that the adjustments made to counteract the tax advantages arising from the arrangements are just and reasonable.
- (2) In determining any issue in connection with the general anti-abuse rule, a court or tribunal must take into account—
 - (a) HMRC's guidance about the general anti-abuse rule that was approved by the GAAR Advisory Panel at the time the tax arrangements were entered into, and

- (b) any opinion of the GAAR Advisory Panel about the arrangements (see paragraph 11 of Schedule 41).
- (3) In determining any issue in connection with the general anti-abuse rule, a court or tribunal may take into account—
 - (a) guidance, statements or other material (whether of HMRC, a Minister of the Crown or anyone else) that was in the public domain at the time the arrangements were entered into, and
 - (b) evidence of established practice at that time.

209 Relationship between the GAAR and priority rules

- (1) Any priority rule has effect subject to the general anti-abuse rule (despite the terms of the priority rule).
- (2) A “priority rule” means a rule (however expressed) to the effect that particular provisions have effect to the exclusion of, or otherwise in priority to, anything else.
- (3) Examples of priority rules are—
 - (a) the rule in section 464, 699 or 906 of CTA 2009 (priority of loan relationships rules, derivative contracts rules and intangible fixed assets rules for corporation tax purposes), and
 - (b) the rule in section 6(1) of TIOPA 2010 (effect to be given to double taxation arrangements despite anything in any enactment).

210 Consequential amendment

- (1) Section 42 of TMA 1970 (procedure for making claims etc) is amended as follows.
- (2) In subsection (2), for “(3ZB)” substitute “(3ZC)”.
- (3) After subsection (3ZB) insert—

“(3ZC) Subsection (2) also does not apply in relation to any claim under section 207 of the Finance Act 2013 (claims for consequential relieving adjustments after counteraction of tax advantage under the general anti-abuse rule).”

211 Interpretation of Part 5

In this Part—

- “abusive”, in relation to tax arrangements, has the meaning given by section 204 (2) to (6);
- “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable);
- “the Commissioners” means the Commissioners for Her Majesty’s Revenue and Customs;
- “the GAAR Advisory Panel” has the meaning given by paragraph 1 of Schedule 41;
- “the general anti-abuse rule” has the meaning given by section 203;
- “HMRC” means Her Majesty’s Revenue and Customs;
- “tax advantage” has the meaning given by section 205;
- “tax arrangements” has the meaning given by section 204(1).

212 Commencement and transitional provision

- (1) The general anti-abuse rule has effect in relation to any tax arrangements entered into on or after the day on which this Act is passed.

- (2) Where the tax arrangements form part of any other arrangements entered into before that day those other arrangements are to be ignored for the purposes of section 204(3), subject to subsection (3).
- (3) Account is to be taken of those other arrangements for the purposes of section 204(3) if, as a result, the tax arrangements would not be abusive.